Supreme Court, U.S.
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87-967

No.

IN THE

SUPREME COURT OF THE UNITED STATES

October Term 1987

AUDREY PRICE, NAILA KURDI, SHARON ATRA, EUGENE STERN, and PATRICIA MARQUARDT, individually and on behalf of all others similarly situated, and HOPE FAIR HOUSING CENTER

Petitioners

vs.

SAMUEL PIERCE, in his official capacity as Secretary of the United States Department of Housing and Urban Development; A. D. VAN METER, in his official capacity as Chairman of the Illinois Housing Development Authority; JAMES KILEY, in his official capacity as Executive Director of the Illinois Housing Development Authority; HAWTHORN RIDGE ASSOCIATES, an Illinois limited partnership; VERNON HILLS ASSOCIATES II, an Illinois limited partnership; TRAILS VENTURE, an Illinois limited partnership; GRANWOOD GARDENS ASSOC., an Illinois limited partnership; PRAIRIEBROOK VENTURE, an Illinois limited partnership; ARROWHEAD APARTMENT ASSOCIATES, an Illinois limited partnership,

Respondents

APPENDIX SUPPORTING PETITION FOR WRIT OF CERTIORARI

BERNARD H. SHAPIRO
Prairie State Legal Services
208 West State Street -Suite 802
Rockford, IL 61101
815 965-2134

GERALD BRASK
Prairie State Legal Services

Counsel for Petitioners

EDITOR'S NOTE

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In the

United States Court of Appeals

For the Seventh Circuit

No. 86-1906

AUDREY PRICE, et al.,

Plaintiffs-Appellants,

v.

SAMUEL PIERCE, et al.,

Defendants-Appellees.

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 83 C 6291—**William T. Hart**, *Judge.*

ARGUED FEBRUARY 13, 1987—DECIDED JULY 8, 1987

Before WOOD JR., POSNER, and MANION, *Circuit Judges.*

POSNER, *Circuit Judge.* In 1974 Congress passed a statute "For the purpose of aiding lower-income families in obtaining a decent place to live and of promoting economically mixed housing." 42 U.S.C. § 1437f(a). (A "lower-income family" is one whose income is no more than 80 percent of the median family income in the area. 42 U.S.C. § 1437f(f)(1) (1976), now § 1437a(b)(2).) The statute authorized the Department of Housing and Urban Development to subsidize both existing housing (§ 1437f(b)(1)) and newly constructed or substantially rehabilitated housing (§ 1437f(b)(2), repealed in 1983). The second provision is the one in issue here, in particular the language authorizing HUD to "make assistance payments pursuant to contracts with owners or prospective owners who agree to

construct . . . housing in which some or all of the units shall be available for occupancy by lower-income families . . . ."

To implement this part of the new program (the "economically mixed housing" or "Section 8" program as it is often called), Congress appropriated money to HUD to pass along to state housing agencies, such as the Illinois Housing Development Authority (IHDA), which in turn would give it to developers. The developers would bill IHDA a specified amount for each apartment rented to a lower-income family and IHDA would be reimbursed by HUD.

Between 1975 and 1978 IHDA made and HUD approved contracts with seven developers, who agreed to lease 40 percent (a total of 482) of the apartments in certain apartment complexes in the Chicago suburbs to lower-income families, in exchange for rent subsidies under section 1437(b)(2); the developers also received mortgage subsidies from IHDA. But then IHDA let developers reduce the percentage of apartments rented to lower-income families to 20 percent. The developers got no rent subsidies from IHDA (financed by HUD) on any of the apartments not rented to lower-income families but they still had the benefit of the mortgage subsidies from IHDA, for these subsidies were not tied to the percentage of units rented, or committed to be rented, to such families. Moreover, the more developments over which HUD's subsidies are spread (because the lower the percentage of lower-income housing in each development), the higher are HUD's costs of administering the Section 8 program, though not its subsidy costs.

In 1981 Congress amended the statute to require developers to fulfill their contractual commitments to rent to lower-income families; until then, as we shall see, federal law did not condition entitlement to Section 8 subsidy on the developer's adhering to its commitment. The amendment does not affect contracts made before 1981. See Act of Aug. 13, 1981, Pub. L. 97-35, §§ 325(1), 371(b), 95 Stat. 357, 406, 431. Nor does the repeal of section 1437f(b)(2)

in 1983 affect this case. See Act of Nov. 30, 1983, Pub. L. 98-181, § 209(a)(2), 97 Stat. 1153, 1183.

This suit was brought in 1983 by five persons who earlier that year had made inquiries about the availability of subsidized apartments at three of the six developments, and by an organization that assists lower-income families to find housing. The defendants are the developers, plus the heads of HUD and IHDA. The individual plaintiffs had been told there were no vacancies and had been placed on waiting lists. Only two of them bothered to fill out an application to rent, both at the same development. The suit claims that the individual plaintiffs are third-party beneficiaries of the contracts between IHDA and the developers, that the developers broke the contracts and HUD refused to enforce them, that IHDA violated section 1437(b)(2), and that IHDA and HUD deprived the individual plaintiffs of property without due process of law. The district court rejected these claims and (so far as pertinent to this appeal) entered judgment for the defendants, after holding that the plaintiffs had standing to bring this suit and after certifying it as a class action on behalf of all similarly situated persons. 615 F. Supp. 173 (N.D. Ill. 1985).

The first issue is whether the plaintiffs have standing to sue. The standing of the organization, and of the three individual plaintiffs who never bothered to fill out formal applications, is doubtful but need not be resolved; it is enough, to give us jurisdiction over the case, if one of the plaintiffs has standing. *Secretary of the Interior v. California*, 464 U.S. 312, 319 n. 3 (1984). The two who filled out applications do. True, if only they are proper plaintiffs, then among the developer defendants only the one to whom those two plaintiffs applied has an actual controversy with a party, and the other developers should be dismissed from the suit. But as we shall be dismissing the suit anyway, it seems unnecessary and ill-advised to get involved in difficult questions of standing that would neither change the outcome nor enable us to avoid a discussion of the merits. A further point is that this

suit was certified as a class action, and perhaps the best way to view the named plaintiffs is as candidates for class representative. If at least one plaintiff had standing when the suit was brought and certified as a class action, and if continuously after that there was a live controversy between at least one defendant and one member of the class (not necessarily a named plaintiff), there is federal jurisdiction. *Sosna v. Iowa*, 419 U.S. 393, 402 (1975). These conditions are satisfied here.

In contesting the standing of the two plaintiffs who filed applications, the defendants point out that eligibility for lower-income housing is not determined until an applicant reaches the head of the waiting list and a vacancy opens up; until then no one can be sure that an applicant would benefit from a favorable decision in this suit. But if the applicant could not sue till there was a vacancy, his suit for an injunction—the premise of which is that the waiting list would be shorter if twice as many apartments were being offered to lower-income families—would be moot as soon as it was ripe.

These two plaintiffs claim without contradiction to have satisfied the formal requirements for eligibility, to have made an application, and to have been placed on the waiting list, and they will get to the head of the list sooner if the developers are ordered to double the number of apartments offered to lower-income persons. So they stand to gain a real benefit from winning this suit. It is true that even if an applicant is formally eligible and makes his interest clear by filling out an application, the developer to whom he has applied may decide not to rent to him; the developer has considerable discretion in this regard, as emphasized in *Eidson v. Pierce*, 745 F.2d 453, 460-61 (7th Cir. 1984), and *Hill v. Group Three Housing Development Corp.*, 799 F.2d 385, 392-93 (8th Cir. 1986). Or the applicant may lose interest before he gets to the top of the list. Or the list might be so long, and the applicant so far from the top, that even if the list were shortened because the number of available apartments had doubled he could never hope to reach the top. But these

possibilities do not defeat standing. A reasonable probability that a plaintiff will get an apartment that he wants sooner if he wins his suit is a sufficiently tangible expected benefit of suit to confer standing under the liberal principles that prevail nowadays, as is demonstrated by *Village of Arlington Heights v. Metropolitan Housing Development Corp.*, 429 U.S. 252, 264 (1977), a factually similar case. If despite the facts we have recited, which make out a prima facie case of standing, neither plaintiff had a reasonable probability of benefiting from a successful conclusion to this suit, this was something for the defendants to show by producing evidence, which they made no effort to do.

Coming to the merits, we first address the claim that the contracts between the developers and IHDA have been broken and that the plaintiffs are entitled to complain about the breach. The questions are intertwined. There is little doubt that the contracts at one time required the developers to set aside 40 percent of the apartments for lower-income families (actually only 32 percent, for reasons explained later, but this makes no difference); for if the 40 percent figure was merely a maximum the contracts contained a tremendous loophole that would have enabled the developers to receive a mortgage subsidy from IHDA even if they never rented a single apartment to a lower-income person. But the nominal parties to the contracts are IHDA and the developers, and they modified the contracts to reduce the percentage to 20 percent. If the plaintiffs are third-party beneficiaries, however, this modification, having been made without their consent, may not have been effective. See Restatement (Second) of Contracts § 311 (1979). Or may have been, as we shall see.

A footnote in the plaintiffs' opening brief asserts that the law governing the contract issues is federal common law. As the defendants take no issue with this assertion we shall treat it as a binding stipulation; we have noted many times that parties to a lawsuit are, within broad limits, entitled to determine what law shall govern their

dispute. E.g., *Casio, Inc. v. S.M. & R. Co.*, 755 F.2d 528, 531 (7th Cir. 1985). But since parties cannot confer federal jurisdiction by stipulation, they cannot confer federal jurisdiction by agreeing that their dispute shall be governed by federal law if, were it not for the stipulation, the suit would arise under state law. *McCall-Bey v. Franzen*, 777 F.2d 1178, 1186 (7th Cir. 1985). Now it is true that even if the contractual dispute in this case were governed by state law, it could be deemed a pendant to the plaintiffs' federal statutory and constitutional claims—and this despite the fact that the defendants are different (the heads of HUD and IHDA rather than the developers); for we recognize "pendent party" jurisdiction where the main claim is a federal-question rather than diversity claim. See *Moore v. Marketplace Restaurant, Inc.*, 754 F.2d 1336, 1360 (7th Cir. 1985). (The citation is to one of the separate opinions, but it stated the view of the majority on this point. See *id.* at 1361.) However, the plaintiffs' federal claims were all resolved before trial; so in the absence of special circumstances (not shown here) the district court would have had to relinquish pendent jurisdiction over the contract claims rather than resolve them on the merits. *United Mine Workers v. Gibbs*, 383 U.S. 715, 726 (1966). Hence it becomes important to decide whether they are federal or state in nature.

Both *Holbrook v. Pitt*, 643 F.2d 1261, 1270 n. 16 (7th Cir. 1981), a suit quite like this, as we shall see, though brought by tenants rather than applicants for subsidized housing under section 1437f, and *D'Amato v. Wisconsin Gas Co.*, 760 F.2d 1474, 1478-80 (7th Cir. 1985), an attempt to sue a contractor for wrongful discharge on the basis of a contract between the contractor and the government, held that the issue of third-party beneficiary status was to be decided as a matter of federal common law; and there is much to be said in support of this result. Section 1437f(b)(2) contemplates that HUD will enter directly or (as here) indirectly (HUD approved the contracts that the plaintiffs allege the developers broke) into contractual relations with developers all over the country,

and the nature and feasibility of those contracts may depend in part on who can sue in the event of a breach. The issue is potentially so important to the success of the program—since on its resolution may turn the amount of lower-income housing actually provided—that we believe that Congress, had it thought about the matter, would have wanted the question to be decided by federal courts applying a uniform principle.

Moreover, although in form the question presents itself as whether a state or federal rule of third-party beneficiaries shall be applied to this case, in substance the question is what remedies shall be available for breach of a contract designed to effectuate the program of economically mixed housing. The question whether prospective tenants can sue, as well as signators of the contracts, is much like the question whether a particular federal statute creates an implied right of action in favor of its beneficiaries, a question invariably treated as one of federal law because it involves (under the current view of implied rights of action) interpretation of the statute. See, e.g., *Touche Ross & Co. v. Redington*, 442 U.S. 560, 568 (1979).

Miree v. DeKalb County, 433 U.S. 25 (1977), however, must give us pause. Victims of an airline crash brought a diversity suit against the owner of an airport, and argued that they were third-party beneficiaries of a contract between the airport and the Federal Aviation Administration obligating the airport to take certain precautions. The Court held that whether they were third-party beneficiaries was a matter of state, not federal, law. The Court noted that the Solicitor General of the United States had declined to participate in the appeal, advising the Court that the resolution of the plaintiffs' breach of contract claim would not have any direct effect on the United States. See *id.* at 29-30. That is not true in this case; but it is noteworthy that the Court went out of its way to reject the suggestion that there was a sufficient federal interest in the question "insofar as such lawsuits [i.e., third-party beneficiary suits by the victims of air crashes] might be thought to advance federal aviation policy by

inducing compliance with FAA safety provisions." *Id.* at 32. The federal interest in the present case could be described in similar terms: an interest in the effect on compliance with the objectives of the program of economically mixed housing if applicants for such housing are allowed to sue to enforce the developers' commitments to IHDA and HUD.

This language in *Miree* is dictum, however, and therefore did not bind us in deciding *Holbrook* and *D'Amato*. The argument for a federal rule is particularly strong in these housing cases; as we suggested earlier, it would be odd to think that a suit by tenants and applicants for federally subsidized housing against developers of such housing for breach of contracts approved by HUD and fundamental to the achievement of HUD's objectives under section 1437f would have to be brought in state court and decided in accordance with state contract law. The case for federal law was much weaker in *Miree*, and we are not obliged to apply all of its language to a case not remotely in the contemplation of the Justices.

There is another wrinkle, however. Merely because the issue of third-party beneficiary status is one of federal common law, it need not follow that the suit by a third-party beneficiary to enforce the contract arises under federal rather than state law, thus entitling the plaintiff to bring the suit in a federal rather than state court. The plaintiffs in this case are suing for breach of contract; establishing their status as third-party beneficiaries merely gives them standing to argue breach. But the reasons that persuade us, notwithstanding the dictum in *Miree*, that the issue of third-party beneficiary status should be treated as one of federal law rest fundamentally on the desirability of a uniform interpretation of these contracts (at least of the provisions requiring federally subsidized lower-income housing), and that will best be achieved by allowing suit in federal courts. We do not suggest, however, that there would be federal jurisdiction of a suit unrelated to commitments made in implementation of the Section 8 program—a suit, for example, over compliance

with contractual provisions relating only to the parts of an apartment development that were not committed for rental to lower-income families, hence not involved in the federal subsidy program.

The next question is whether, as a matter of federal common law, the plaintiffs should have a right to maintain a suit on the contract between the developers and IHDA. In *Holbrook* we held that tenants under federal housing programs are third-party beneficiaries of the contracts between HUD (or, by implication, an agent, such as IHDA) and developers of lower-income housing. 643 F.2d at 1269-73. The holding was based on our answering "yes" to the question: "did the contracting parties intend that the third party benefit from the contract?" *Id.* at 1270 n. 17. In view of our approving discussion of the provision in the Restatement of Contracts that "a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties," Restatement, *supra*, § 302 (*Holbrook* quoted an earlier version of this provision, but one unchanged in the final version), and our statement that "it is improper to neglect the reasonable expectations of the promisor, since the burden of the agreement to the promisor, and therefore the consideration he will require, may vary according to the number of parties who have enforceable rights under the contract," 643 F.2d at 1270 n. 17, an equivalent formulation of our test is whether the contracting parties intended the third party to have a right to sue in the event of breach. See also *Nguyen v. United States Catholic Conference*, 719 F.2d 52, 55 (3d Cir. 1983); *Roberts v. Cameron-Brown Co.*, 556 F.2d 356, 362 (5th Cir. 1977). An affirmative answer was at least plausible in *Holbrook*; HUD would hardly wish to undertake the burden of suing for breach of contract every time a developer violated his duty toward a tenant. Granted, this explanation for the decision is in tension with the fact that HUD was opposing the recognition of third-party beneficiary status. But maybe it had just changed its mind; in any event it seemed

09

more sensible to us to make the developer's undertakings to the tenant in the contract with HUD in effect an additional term of the tenant's lease than to place the entire burden of enforcement on HUD, and it was also a result consistent with the statutory objectives.

An inference of third-party beneficiary status is less plausible in the case of a mere applicant for subsidized housing. Cf. *Eidson v. Pierce*, *supra*, 745 F.2d at 460-62. Although it can be argued that such applicants are not merely incidental beneficiaries of the contracts with the developers, as were the plaintiffs in *D'Amato v. Wisconsin Gas Co.*, *supra*, 760 F.2d at 1480, to give each applicant for subsidized housing the status of a party to the contract would make almost every lower-income person in the United States a potential plaintiff and would thus be inconsistent with the Restatement's provision on third-party beneficiaries of government contracts. See Restatement, *supra*, § 313(2). A developer who signed a contract with IHDA would be buying potential legal trouble not only with the relative handful of lower-income families to which he might actually rent but with all the lower-income families in the region who might desire and be eligible to rent apartments that he had committed to such families. The parties suggested that there might be 30,000 eligible persons in DuPage County alone, one of three counties in which the apartments at issue in this case are located. Of course many such suits might fail for want of standing, but that is not a good argument for deeming the plaintiffs third-party beneficiaries. On the contrary, the original parties to a contract would hardly want to create rights of action in so indefinite a class as to raise a serious question whether the members would actually be allowed to enforce their rights. It is implausible that the developers, IHDA, or HUD ever intended to impose so novel and ill-defined a burden on themselves or that it would advance the objectives of the Section 8 program if they did; so wide a net of liability could make developers reluctant to participate in the program.

We hold that the developers did not assume contractual liability to applicants, but we would affirm the dismissal of the plaintiffs' breach of contract claim even if they had. Unless a contract expressly prohibits the parties from modifying their duties to intended beneficiaries, which the contracts in this case do not do, the parties can modify the contract without any such beneficiary's consent unless and until he justifiably relies on it. See Restatement, *supra*, § 311; *Karc v. San Diego Symphony Orchestra Ass'n*, 762 F.2d 819, 822 (9th Cir. 1985); *Detroit Bank & Trust Co. v. Chicago Flame Hardening Co.*, 541 F. Supp. 1278, 1282-83 (N.D. Ind. 1982). No reliance, justifiable or otherwise, has been shown or suggested here. The wisdom of the rule is shown by the circumstances of this case. It would be absurd to freeze the developers, IHDA, and HUD into the original terms of the contracts, no matter what the circumstances calling for modification; and frozen they would be, since it would be infeasible, or at least very burdensome, to negotiate a release from all applicants for lower-income housing.

And since the contracts were lawfully modified, HUD cannot be faulted for having refused to enforce them according to their original tenor. So we need not decide whether this case falls within any of the exceptions to the rule that agency inaction is inactionable. See *Heckler v. Chaney*, 470 U.S. 821 (1985).

The next issue is statutory violation. Although section 1437f(b)(2) does not create a private right of action either explicitly or by implication, see *Hill v. Group Three Housing Development Corp.*, *supra*, 799 F.2d at 394-95, the Supreme Court held recently that section 1 of the Civil Rights Act of 1871, now 42 U.S.C. § 1983, may be used as a vehicle for suing state housing officials, such as the head of IHDA, for depriving lower-income tenants of their rights under federal housing law. *Wright v. City of Roanoke Redevelopment & Housing Authority*, 107 S. Ct. 766 (1987). But there was no violation of the 1974 statute, and the 1981 statute is not retroactive. The 1974 statute says nothing about developers' having to rent to lower-income

families all the apartments they have committed to rent to them, and there is no pertinent legislative history. Of course the developers can't get federal subsidies for apartments not rented to lower-income families, see 42 U.S.C. § 1437f(c)(4), but they have not tried to. Developers who do not rent all the "committed" units free up federal subsidies for other developers.

The concept of economically mixed housing was new in 1974 and no one knew what the optimum mixture was. Housing ordinarily is segregated by income; and though the draftsmen of the 1974 statute wanted to change this, they did not stipulate to a minimum percentage of lower-income people in developments that received rental subsidies under the statute or even require state housing agencies to hold developers to whatever commitments they made. Apartments not rented to lower-income families would be ineligible for rental subsidies, but the developer would not be penalized (at least under the statute) for not renting to as many lower-income families as he had promised to rent to. The statute even contains a provision giving preference to projects in which no more than 20 percent of the units are reserved for lower-income people, see 42 U.S.C. § 1437f(c)(5), which is the percentage to which the developers retreated here, albeit in derogation of their original commitment to IHDA. Congress was evidently alert to the danger of "tipping"; it did not require such high percentages that tipping would become highly likely.

It is true that HUD early on promulgated a regulation which requires developers to rent no more than 20 percent of the units reserved for lower-income housing to ineligible tenants. See 24 C.F.R. § 883.327 (1979, but in force from 1975 on). But this regulation, which (as amended in 1980, see 24 C.F.R. § 883.605) states expressly that a developer who violates it is breaking his contract, represents we believe an exercise of HUD's power to make contracts implementing the statute rather than an interpretation of a statutory duty of developers to adhere to their contractual commitments. (It is the 20 percent lee-

way in the regulation that caused us to say earlier that the developers' commitment was actually 32 percent rather than 40 percent.) HUD could decide to extract an ironclad (or, rather, an 80 percent ironclad) commitment from developers, or it could decide to delegate to state agencies such as IHDA the decision of how closely to hold the developers to their commitments in the face of such changed circumstances as experience might reveal. Notice by the way how giving applicants for lower-income housing the status of third-party beneficiaries would reduce HUD's flexibility, unless—as we also believe—contracts can be modified by their original parties without leave of any third-party beneficiaries until the latter have justifiably relied on the original provisions.

When the General Accounting Office (not HUD) discovered that developers were not fulfilling their commitments, it was distressed and applied pressures that eventuated in the 1981 amendment. See for example the ominously entitled Report by the Comptroller General of the United States: Lenient Rules Abet the Occupancy of Low Income Housing by Ineligible Tenants (U.S. Gen'l Accounting Off., CED-81-74, April 27, 1981). But the plaintiffs' argument that the amendment merely clarified the 1974 statute is untenable. The explicit denial of retroactive application argues the contrary, and there is nothing to be clarified about the 1974 statute so far as any obligation to fulfill contractual commitments is concerned: there is no hint of such an obligation. Finally, the legislative history contains no suggestion that the purpose of the 1981 amendment was merely to clarify the original statute.

The repeal of the provisions of the economically mixed housing statute relating to newly constructed and substantially rehabilitated housing, just two years after the 1981 amendment, suggests that IHDA may have been on the right track in allowing the developers to renege on their commitments. Economically mixed housing is a noble idea but also a precarious one. If the percentage of poor people in a project rises too far, the other tenants may leave,

and the purpose of the program be defeated. Maybe 20 percent is the highest feasible percentage of poor people (not that all lower-income people as defined by the statute are poor) in such a program, and the GAO's pressure for a higher percentage merely accelerated the program's demise. But the only important point is that the 1974 statute did not contain the inflexible requirement on which the plaintiffs rely.

The last issue is whether IHDA and HUD deprived the plaintiffs of their property without due process of law. Since the defendants did not violate the statute and the plaintiffs had no contract rights, the plaintiffs were not deprived of any entitlement, and hence of any property. Compare *Eidson v. Pierce, supra*, 745 F.2d at 457-64. So this claim fails, too; and the judgment for the defendants must be, and is,

AFFIRMED.

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UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604
August 4, 1987
Before

Hon. HARLINGTON WOOD, JR., Circuit Judge
Hon. RICHARD A. POSNER, Circuit Judge
Hon. DANIEL A. MANION, Circuit Judge

AUDREY PRICE, et al.,)
Plaintiffs-Appellants,)
)
VS.) No. 86-1906
)
SAMUEL PIERCE, et al.,)
Defendants-Appellees.)

ORDER

On July 22, 1987, plaintiffs-appellants filed a petition for rehearing with suggestion for rehearing en banc. All of the judges on the original panel have voted to deny the petition, and none of the active members of the court[1] has requested a vote on the suggestion for rehearing en banc. The petition is therefore DENIED.

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[1]Hon. Frank H. Esterbrook did not participate in the consideration of the suggestion for rehearing en banc.

Audrey PRICE, et al., Plaintiffs,

v.

Samuel PIERCE, etc., etal.,

Defendants.

No. 83 C 6291.

United States District Court,

N.D. Illinois, E.D.

June 25, 1985.

MEMORANDUM OPINION AND ORDER

WILLIAM T. HART, District Judge.

The Hope Fair Housing Center ("HOPE") and the six individually named plaintiffs brought this action against Secretary of Housing and Urban Development Samuel Pierce (the "Secretary"), the Illinois Housing Development Authority ("IHDA"), and the owners of six "Section 8" housing complexes located in this District (the "Developers"). Their complaint seeks "full utilization" of housing subsidies

contractually allocated for use by low and moderate income families at the apartment complexes owned by the defendant Developers. Initially, the plaintiffs sought to enforce a policy of full utilization by invoking: (i) their Fifth and Fourteenth Amendment due process rights; (ii) an implied private right of action under the Housing Act of 1937, as amended (referred to as "Section 8"), 42 U.S.C. §§1437f et seq.; (iii) section 1983 as a remedy for violations of their rights under (i) and (ii); (iv) judicial review of the Secretary's actions pursuant to the Administrative Procedure Act ("APA"), 5 U.S.C. §706; (v) their rights as third party beneficiaries under contracts between the Secretary, IHDA and the Developers; and (vi) an implied right of action under the Illinois housing laws.

By order entered November 28, 1983, the Court dismissed the plaintiffs' third party beneficiary claim and refused to recognize an implied private right of action under the Housing Act, but rejected the defendants' assertion that the plaintiffs had no property right in Section 8 benefits sufficient to sustain their due process and §1983 claims. Also, in the November 23rd order, the Court reserved ruling on the defendant's challenge to Hope's standing as a plaintiff, pending the Seventh Circuit's decision in a similar case.

On April 4, 1984, this Court certified a class of plaintiffs who were financially eligible for Section 8 assistance and otherwise acceptable for tenancy at the defendant Developers' apartment complexes but had been adversely affected by the alleged policy

of underutilization.[1] In addition, the Court acting sua sponte, dismissed IHDA as a party defendant to the plaintiffs' §1983 and state law claims based on the Supreme Court's decision in Pennhurst State School and Hospital v. Halderman, 465 U.S. 89, 104 S.Ct. 900, 79 L.Ed.2d 67 (1984). As a result of a series of motions to reconsider, clarify and join additional parties, on November 13, 1984 the plaintiffs filed a fourth amended complaint, which dismissed IHDA as a party defendant and joined IHDA officials A.D. Van Meter and James Kiley (together the "State defendants") as defendants to their due process and §1983/federal housing act claims.

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[1]The precise definition of the class is set forth at p. 11 of the April 4th order.

Currently before the Court are the parties' cross-motions for summary judgment on the claims advanced in the plaintiff's four-count fourth amended complaint(denial of property without due process, violation of rights under the federal housing laws, judicial review of the Secretary's actions, and violation of state housing laws).

STANDING

[1] Initially, the State defendants' challenge to the plaintiffs' standing to maintain this action must be resolved. The State defendants maintain that the Seventh Circuit's decision in Hope, Inc. v. County of DuPage, 738 F.2d 797 (7th Cir.1984), mandates a finding that neither Hope nor the individual plaintiffs have standing to maintain this action. In County of DuPage, the Seventh Circuit found that the plaintiffs lacked

standing to challenge alleged County Board practices where they had failed to identify specific housing projects affected by the challenged practices, as required by Warth v. Seldin, 422 U.S. 490, 95 S.Ct. 2197, 45 L.Ed.2d 343 (1975). County of DuPage is no bar to the standing of the individual plaintiffs here, as they have alleged (and shown) that the challenged practice of "underutilization: affected the availability of housing at six specific apartment complexes where they are applicants for housing.

[2] This Court reserved ruling on Hope's asserted standing as a representative of its members and in its own right while the County of DuPage was being argued. The Seventh Circuit did not base its ruling on grounds which would differentiate Hope from the

individual plaintiffs. Rather, the Seventh Circuit found that since Hope's standing was no better than that of the individual plaintiffs, it too lacked standing. County of DuPage also refused to expand Hope's representational standing beyond its members to include all those for whom Hope seeks housing. Here, Hope has presented the claim of particularized injury that was lacking in County of Dupage. Hence, Hope has standing both as a representative of its members (who are otherwise within the class as certified) and in its own right to maintain this action. See Havens Realty Co. v. Coleman, 455 U.S. 363, 378-79, 102 S.Ct. 1114, 1124, 71 L.Ed.2d 214 (1982).

DUE PROCESS CLAIMS

All defendants assert that in light of the Seventh Circuit's recent

decision in Eidson v. Pierce, 745 F.2d 453 (7th Cir.1984), the plaintiffs' due process claims fail for want of a property right requiring due process protection. The State defendants go on to assert that Eidson also precludes the plaintiffs' §1983 claim, which is based upon a violation of purported rights established by the federal housing laws.

Eidson involved an effort by applicants for Section 8 housing at apartment complexes in Indiana and Wisconsin to secure hearings and a written explanation of the reasons for their rejection by project owners. As do the plaintiffs in this action, the Eidson plaintiffs argued that financially eligible applicants enjoy a property right to Section 8 benefits deserving due process protection. The Seventh Circuit

flatly rejected their asserted property right.

[3] The plaintiffs contend that this case is distinguishable from Eidson as it involves a challenge to the total amount of Section 8 housing available to all applicants rather than "the process used to allocate these limited and valuable benefits among a large number of eligible applicants' examined in Eidson. 745 F2d at 457. However, a fair reading of Eidson does not support this distinction. This Court's November 23rd order, which denied the defendant's motion to dismiss the due process claim, recognized but rejected the tenant/applicant distinction adopted by the district courts in Eidson and Germain v. Recht-Goldin-Seigel Properties (consolidated on appeal with Eidson). In rejecting the tenant/applicant

distinction, this Court relied upon Ressler v. Pierce, 692 F.2d 1212 (9th Cir.1982) and Davis v. Ball Memorial Hospital Ass'n, 640 F.2d 30 (7th Cir.1980). However, in Eidson the Seventh Circuit adopted the tenant/applicant distinction, rejected the rationale of Ressler and limited the reach of Davis. The relevant distinction mandated by Eidson is between procedural rights to preserve the existing amount of available housing for all applicants and procedures to allocate housing among applicants. Since the plaintiffs here are all applicants, their due process claims are foreclosed by Eidson.

SECTION 1983 CLAIM

Moreover, Eidson also defeats plaintiffs' §1983 claims based on the federal housing statute. The plaintiffs rely upon Maine v. Thiboutot, 448 U.S. 1,

100 S.Ct. 2502, 65 L.Ed.2d 555 (1980), for the proposition that "a federal statute creating enforceable rights may be enforced in a Section 1983 action," despite the absence of any implied private right of action under the statute itself. However, the plaintiffs' argument assumes its conclusion. The Seventh Circuit in Eidson found that "there is nothing to suggest that Congress intended potential tenants of Section 8 projects to have enforceable rights to Section 8 housing in particular projects." 745 F.2d at 462.

[4,5] The Supreme Court has recognized two exceptions to the application of §1983 to federal statutes, one of which precludes plaintiffs' §1983 claim. No §1983 claim may be based on a federal statute which fails to create "enforceable rights." See Middlesex City

Sewerage Authority v. Sea Clammers, 453 U.S. 1, 9, 101 S.Ct. 2615, 2620, 69 L.Ed.2d 435 (1981) (explaining Pennhurst State School and Hospital v. Halderman, 451 U.S. 1, 18 101 S.Ct. 1531, 1540, 67 L.Ed.2d 694 (1981)). See also Gould, Inc. v Wisconsin Dept. of Industry, Labor & Human Relations, 750 F.2d 608, 615-16 (7th Cir.1984); Polchowski v. Gorris, 714 F2d 749, 750-51 (7th Cir. 1983). Thus, the plaintiffs' §1983 claim rises or falls with its due process claim, as both assert 42 U.S.C. §1437f to be the source of enforceable rights. Since Eidson has established that applicants (as opposed to tenants) for Section 8 housing have no "enforceable right" to benefits, see 745 F.2d 461 n.6, that portion of the federal housing law provides no basis for a §1983 claim. Accord Phelps v. Housing Authority of Woodruff, 742 F.2d 816, 820-

22 (4th Cir.1984). But see Tedder v. Housing Authority of Paducah, 574 F.Supp. 240, 246-48 (W.D.Ky.1983).

STATE LAW CLAIMS

[6,7] Due to the disposition of the plaintiffs' due process and §1983 claims, their pendent claims based on state housing statutes, must be dismissed. After the entry of summary judgment on Counts I and II, the only claim remaining against the defendant Developers is the plaintiffs' claim under the state housing laws (Count IV). In the absence of benefits in the for of judicial economy, convenience or fairness to litigants, "federal courts should be reluctant" to adjudicate state law claims. Buethe v. Britt Airlines, Inc., 749 F.2d 1235, 1240 (7th Cir.1984) (quoting Smith v. No. 2 Galesburg Crown Finance Corp., 615 F.2d 407 (7th

Cir.1980). Such a reluctance should be particularly pronounced where the state law claim involves an issue of first impression or an unsettled area of state law as is presented here. Buethe, 749 F.2d at 1240-41. In addition, the plaintiffs' state law claim against the Developers is a pendent party claim not closely related to the remaining federal law claim against the Secretary. Compare Berstein v. Lind-Waldock & Co., 738 F.2d 179, 187-88 (7th Cir. 1984) with Moore v. Marketplace Restaurant, Inc., 754 F2d 1336, 1359-63 (7th Cir.1985). For these reasons, the plaintiffs; state law claim is dismissed without prejudice.

ADMINISTRATIVE REVIEW CLAIMS

The plaintiff's remaining claims are that the Secretary has: (i) unlawfully withheld action which would compel the Developers and IHDA to fully

utilize authorized Section 8 subsidies; and (ii) abused his discretion by approving proposed contact modifications which would reduce the number of authorized Section 8 units at five of the six apartment complexes involved in this action.

[8,9] Section 706(1) of the APA, 5 U.S.C. §706(1) empowers federal courts to "compel agency action unlawfully withheld" (emphasis added). Judicial review of claims of agency inaction is extremely limited. Illinois Bell Telephone Co. v. F.C.C., 740 F.2d 465, 475-76 (7th Cir.1984). Further, the Secretary enjoys considerable discretion in making enforcement decisions. See United States v. OCCI Co., 758 F.2d 1160, 1164-65 (7th Cir.1985) (foreclosure on federally insured mortgage for low and moderate income housing project). The

Secretary argues that his failure to take action to remedy the underutilizationn at the five apartment complexes owned by the defendant Developers was not unlawful, as no applicable statute required full utilization.

[10] The plaintiffs concede that the 1981 amendments to Section 8 do not apply to the apartment complexes here at issue. Although Congress mandated full utilization as part of the 1981 amendments, it provide that the full utilization requirement would apply only to contracts entered into on or after October 1, 1981. PL 97-35 §§325(1) and 371(b), 95 Stat. 406, 431 (Aug. 13, 1981). Plaintiffs' attempt to construct a statutory requirement of full utilization from various other portions of Section 8 is unpersuasive. Thus, the Secretary's failure to act was not

unlawful and enforcement action cannot be compelled under 5 U.S.C. §706(1).

[11,12] The Secretary's approval of a reduction in the number of Section 8 assisted units at five of the six apartment complexes, however, stands on a different footing. Pursuant to 5 U.S.C. §706(2)(A), this Court must review the Secretary's decision to determine whether the decision was based on a consideration of the relevant facts and whether there has been a clear error of judgment." Citizens To Preserve Overton Part v. Volpe, 401 U.S. 402, 416, 91 S.Ct. 814, 824, 28 L.Ed.2d 136 (1971). Nonetheless, this standard of review is also narrow and this Court may not "substitute its judgment for that of the agency." Id. Even where an abuse of discretion is shown, the proper remedy is a remand to the Secretary rather than the

substitution of this Court's judgment for that of the Secretary. Flynn v. Schultz, 748 F.2d 1186, 1194 (7th Cir. 1984). With this deferential standard in mind, the Court examines the record supporting the Secretary's decision.

Under the Section 8 program, the Secretary is authorized to implement the program by entering into annual contributions contracts ("ACC") with a "public housing agency," pursuant to which such agency may enter into housing assistance payments ("HAP") contracts with owners of dwelling units to assist eligible persons. IHDA is a public housing agency within the meaning of federal statute and is governed by federal regulations at 24 C.F.R. §883.101, et seq. IHDA was established pursuant to Illinois state law. Ill.Rev.Stat. ch. 67 1/2, Paragraph 301

et seq. IHDA has provided "assisted mortgage financing"[2] for each of the six developments in this action, pursuant to state statute. Ill.Rev.Stat. ch. 67 1/2, Paragraph 307.2.

(1) Trails Venture

The Moorings, located in DuPage County is owned by defendant Trails Venture, an Illinois limited partnership. In 1976, IHDA requested that the Department of Housing and Urban Development ("HUD") increase the Section 8 subsidy allocation at the Moorings to 40% (86 units) of the dwelling units of that development. IHDA stated in part:

> As always the Authority evaluates the economic housing needs of each community where a project is proposed and correspondingly

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[2]Under Illinois law "assisted mortgage financing" means a below market rate mortgage, insured or purchased, in combination with a program of rent supplements and other grants.

> requests the appropriate amount of housing subsidies required for the community to be served as determined by our housing need study... It is our conclusion, after analyzing present housing cost and family income patterns, that 40% of the dwelling units should be assisted with Section 8 housing assistance payments in conformance with our housing needs study... In view of the foregoing, it is imperative that the subsidy be available to allow us to assist very low, low and moderate income families in the spirit and intent of the congressional mandate enumerated through the Housing and Community Development Act of 1974.

On April 7, 1976, HUD approved the IHDA proposal for the Moorings. On May 4, 1976, HUD and IHDA signed an ACC for the purpose of making Section 8 subsidies available for 86 units at the Moorings through execution of a HAP contract with the owner. On May 4, 1976, IHDA and defendant Trails Venture signed, and HUD subsequently approved, an Agreement to Enter Into HAO Contract,

"for the purpose of making housing payments to enable eligible Lower-Income Families to occupy units in said project."

In March, 1977, IHDA and Trails Venture signed a HAP contract, approved by HUD inn May, 1977, providing in part that:

> The Contract Units [§8 units] are to be leased by the owner to eligible lower-income families ("Families") for use and occupancy by such families solely as private dwellings... The HFA [IHDA] hereby agrees to make housing assistance payments on behalf of families for the contract units to enable such families to Decent, Safe and Sanitary Housing pursuant to Section 8 of the act.

From the time of initial occupancy until September 1983, the Moorings rented no more than 43 apartments to eligible low income tenants. On August 26, 1983, IHDA and Trails Venture amended the contracts,

reducing the available Section 8 allocation from 86 to 68 Section 8 units. HUD approved this change.

(2) Arrowhead Apartment Associates

Arrowhead Village, located in Cook County, is owned by defendant Arrowhead Apartment Associates, an Illinois limited partnership. Arrowhead Village was previously owned by defendant Groves of Hidden Creek, an Illinois limited partnership.

In 1976, IHDA by and through its Director, requested from HUD an increase in the Section 8 subsidy allocation at Arrowhead Village to 40% of the dwelling units at that development (80 units). IHDA made the identical representation quoted at page 11 of this opinion.

On February 12, 1976, HUD approved the IHDA proposal for Arrowhead. On June 30, 1976, HUD and IHDA signed an

ACC for the purpose of making Section 8 subsidies available (80 units) at the Groves of Hidden Creek through execution of a HAP contract with the owner and HUD subsequently approved the agreement. On March 24, 1976, IHDA and Groves of Hidden Creek signed a HAP contract, approved by HUD in May, 1977, containing the identical provision quoted at page 179 of this opinion.

On April 19, 1982 in a letter to Arrowhead Village, HUD Area Manager Elmer Binford stated:

> We are deeply concerned since our records indicate that of the 80 units under your Section 8 Contract, less than 50% (39 units) are currently under lease to eligible Section 8 tenants. Current regulations found in 24 CFR Part 883.605(a) require that no more than 10% of assisted units be leased to ineligible tenants without prior HUD and State Agency (IHDA) approval. Failure to lease to eligible tenants is a violation of your Contract and constitutes grounds

> for all available legal remedies, including specific performance of the Contract suspension or debarrent [sic] from hud programs and reduction of the number of units under the contract.
>
> Within 10 days following your receipt of this letter, we request your written response to the charge made by Mr. Barnett and a justification of your failure to lease Section 8 units to eligible tenants. A copy of this letter is being forwarded to the Illinois Housing Development Authority.

On June 9, 1982, in a letter to Arrowhead Apartments, HUD area manager Elmer Binford stated:

> Regarding the matter of your agency's failure to lease Section 8 units to eligible tenants, your response completely ignores this issue. In addition, you have provided us a copy of a response to the Barnett's from Donnell D. Jenkins, Amdur Associates, Inc., Property Manager, that contains statements that contradict information contained on official HUD reports. Specifically, HUD Form 52684, Report on Program Utilization, which was filed on behalf of Arrowhead Apartments, by the Illinois Housing Development Authority indicates

that as of January 13, 1981 only 39 of 80 units (50%) were leased to eligible tenants. Further information received by this office indicates that as of May, 1982, this situation has not improved. Any unauthorized policy of leasing to ineligible tenants above the allowable program limit results in the unlawful deprivation of Federally-funded rental assistance to eligible Section 8 applicants. This policy is especially disturbing since your agency acknowledges a very lengthy waiting list for Section 8 at Arrowhead.

As was indicated in our letter of April 19, 1982, failure to lease to eligible tenants is a violation of your Housing Assistance Payments contract and grounds for all available legal remedies. In addition, your unauthorized policy has the effect of depriving those eligible families of their constitutional right to participate in this Federally-funded program.

On June 15, 1982, in a letter to IHDA deputy Director, Peter Dwars, HUD Area manager Elmer Binford stated:

Recently, it has come to our attention that IL06-H121-007,

Arrowhead Village, has consistently violated Federal regulations by leasing Section 8 units to ineligible tenants in a percentage that exceeds statutory limits. We had requested that the owner of this project provide this office with some clarification of this unauthorized procedure. As the result of our request, we were informed by an IHDA employee that your agency would provide an adequate response.

In a June 15, 1981 letter from Mr. Delong, we were provided with a response that we feel is less than adequate. We concur in Mr. Delong's analysis that this project is governed by regulations that were in effect prior to February 29, 1980, however, we are not aware of any Federal regulations that allow a project owner to lease more than 20% of its Section 8 units to ineligible tenants. IL06-H121-007 has consistently leased more than 50% of its Section 8 units to ineligible families.

We would appreciate your response to this matter inasmuch as our records show that this project is being managed in violation of Federal regulations.

From the time of initial occupancy until September, 1983, Arrowhead rented no more than 40 apartments to eligible low income tenants.

On August 26, 1983, IHDA and Arrowhead changed the contracts, reducing the available Section 8 allocation from 128 to 110 units. HUD approved the change.

(3) Hawthorn Ridge Associates

Hawthorne Ridge Apartments ("Hawthorne"), located in DuPage County, Illinois, is owned by defendant Hawthorn Ridge Associates, an Illinois limited partnership.

On December 11, 1975, and in January, 1976, IHDA requested from HUD an increase in the Section 8 subsidy allocation of Hawthorn to 40% of the dwelling units at that development (70

units). IHDA stated in part on January 7th:

> This change is requested as a result of our recent analysis of the economic impact of market rate rents for new construction in light of present and projected recession and inflation trends. In our opinion, only a small minority of the families in the Village of Woodridge are able to afford dwelling units which are not 100% subsidized.

On December 23, 1975, HUD approved the IHDA proposal for Hawthorn. In December, 1975, HUD and IHFA signed an ACC for the purpose of making Section 8 subsidies available for 76 units at Hawthorn through execution of a HAP contract with the owner. In December, 1975, IHDA and Hawthorn Ridge Associates signed, and HUD subsequently approved, an agreement. On April 25, 1977, IHDA and Hawthorn Ridge Associates signed a HAP contract approved by HUD in May 1977, providing that:

> The Contract units [§8 units] are to be leased by the owner to eligible lower-income families ("Families") for use and occupancy by such families solely as private dewellings"... The HFA (IHDA) hereby agrees to make housing assistance payments on behalf of families for the contract units to enable such families to lease Decent, Safe and Sanitary Housing pursuant to Section 8 of the Act.

From the time of initial occupancy to September 1983, Hawthorn rented no more than approximately 35 apartments to eligible low income tenants. On August 26, 1983, with HUD approval, IHDA and Hawthorn Ridge Associates changed the contracts, reducing the available Section 8 allocation from 70 to 52 Section 8 units.

(4) Vernon Hills Associates II

Pebbleshire II, located in Cook County is owned by defendant Vernon Hills Associates II, an Illinois limited partnership. On January 7, 1976, IHDA

requested from HUD an increase in the Section 8 subsidy allocation at Pebbleshire II to 40% of the swelling units at that development (58 units). IHDA supported its request with the statement quoted at page 179 of this opinion.

On September 20, 1976, HUD approved the IHDA proposal for Pebbleshire II. In July and September, 1976, HUD and IHDA signed an ACC for the purpose of making Section 8 subsidies available at Pebbleshire II through execution of a HAP contract with the owner. On September 22, 1976, IHDA and Vernon Hills Associates II signed, and HUD subsequently approved an agreement. On December 30, 1977, IHDA and Vernon Hills Associates II signed a HAP contract, approved by HUD on March 10, 1978 providing in part that:

> The Contract Units [58 units] are to be leased by the owner to eligible low-income families for use and occupancy by such families as private dwellings... The HFA [IHDA] hereby agrees to make housing assistance payments on behalf of families for the contract units to enable such families to lease Decent, Safe and Sanitary Housing pursuant to Section 8 of the Act.

From the time of initial occupancy until September, 1983, Pebbleshire II rented no more than 29 apartments to eligible low income tenants. On August 26, 1983, IHDA and Vernon Hills Associates II changed the contracts, with HUD approval, reducing the available Section 8 allocation from 58 to 40 Section 8 units.

(5) Prairiebrook Venture

Prairiebrook, located in Lake County, is owned by Defendant Prairiebrook Venture, an Illinois limited partnership. On October 30, 1975, HUD

approved the Prairiebrook proposal to provide 320 units of housing, of which 128 units were to be subject to contract for Section 8 subsidies on behalf of lower income families. IHDA certified, according to federal regulations, that the authority had found a need for housing assistance for the number and size of the units applied in the subject development based upon its approved housing needs study.

On October 31, 1975, HUD and IHDA signed an ACC for the purpose of making Section 8 subsidies available at Prairiebrook through execution of a HAP contract with the owner. In September and October 1975, IHDA and Prairiebrook Venture signed, and HUD subsequently approved an agreement. In 1977, IHDA and Prairiebrook Venture signed a HAP

contract approved by HUD in May, 1977, providing in part that:

> The Contract Units [§8 Units] are to be leased by the owner to eligible low-income families for use and occupancy by such families as private dwellings... The HFA [IHDA] hereby agrees to make housing assistance payments on behalf of families for the contract units to enable such families to lease Decent, Safe and Sanitary Housing pursuant to Section 8 of the Act.

From the time of initial occupancy until September, 1983, Prairiebrook rented no more than 64 units to eligible low-income tenants. On August 26, 1983, IHDA and Prairiebrook Venture changed the contracts, reducing the available Section 8 allocation from 128 to 110 units. HUD approved this change.

(6) Grandwood Gardens Associates

Grand Oaks, located in Lake County, is owned by defendant Grandwood

Gardens Associates, an Illinois limited partnership. In 1976, IHDA requested from HUD an increase in the Section 8 subsidy allocation at Grand Oaks to 40% of the dwelling units at that development (60 units). IHDA supported its request by the identical representation quoted at page 179 of this opinion. On March 5, 1976, HUD approved the IHDA proposal for Grand Oaks "to provide 150 units of housing of which 60 units are to be the subject of a contract for the making of housing assistance payments on behalf of eligible lower-income families leasing such units."

In May and July 1976, HUD and IHDA signed an ACC for the purpose of making Section 8 subsidies available at Grand Oaks through execution of a HAP contract with the owner. On March 17, 1976, IHDA and Grandwood Gardens signed,

and HUD subsequently approved an agreement. In March and May, 1976, IHDA and Grandwood Gardens Associates signed a HAP contract, approved by HUD in May, 1977, providing in part that:

> The Contract Units [§8 Units] are to be leased by the owner to eligible low-income families for use and occupancy by such families as private dwellings... The HFA [IHDA] hereby agrees to make housing assistance payments on behalf of families for the contract units to enable such families to lease Decent, Safe and Sanitary Housing pursuant to Section 8 of the Act.

From the time of initial occupancy until November 1, 1984, Grand Oaks rented no more than 30 units to eligible low-income tenants, except for a period in which it received permission from IHDA to rent up to 36 units to Section 8 families.

On October 9, 1980, in a letter to IHDA, Amder Associates stated regarding Grand Oaks:

> "Thank you for recognizing the occupancy problem existing at Grand Oaks and for permitting us to increase our subsidized occupancy by six apartment units. We understand that this increase is to be a temporary measure. It is our intention to bring the subsidized occupancy back to the 20% design allocation as conditions permit."

By letters dated July 27, 1983 and July 28, 1983, IHDA, without any detailed statement of its reasons, requested that the Secretary transfer Section 8 authorizations for a total of ninety units from five of the involved apartment complexes (18 from each complex) in DuPage, Cook, and Lake Counties to Grand Oaks in Lake County. The effect of the proposal would have been to make Grand Oak's a 100% subsidized project and also to remove

units from DuPage and Cook Counties. The July 27th IHDA letter states that the reductions are proposed "to provide for the needed increase [at Grand Oaks]." The July 28th IHDA letter states that the reductions in assisted units at the five complexes are "contemplated if and only if the recaptured funding is assigned" to Grand Oaks.

Without any discussion, by letter dated August 31, 1983, the Secretary approved reductions of 18 units each in the Section 8 authorizations of the five apartment complexes, as requested by IHDA. Also on August 31, 1983, Chicago Area Manager Everett H. Rothschild wrote to IHDA approving the increase in Section 8 units at Grand Oaks and explaining that the increase was to be funded by the decreases at the other complexes (this approval was apparently not the final

word). By letters dated September 30, 1983, IHDA notified each of the Developers, except Grandwood Garden Associates, of the Secretary's approval, enclosing the approved contract amendments.

On September 15, 1983, the Lake County Department of Planning, Zoning and Environmental Quality advised HUD that the proposal to convert Grand Oaks to 100% Section 8 occupancy was "unacceptable" and "inconsistent with Lake County's Housing Assistance Plan." The County also complained that the project would become identified as a low income dwelling which would be inconsistent with the Section 8 program. On December 29, 1983, IHDA wrote the Secretary, urging approval of the Grand Oaks proposal and stating "the re-allocation strategy contemplated is

attractive to us for the reason that it preserves the total number of subsidized units." Although the record fails to disclose any direct communication between the Developers and the Secretary regarding IHDA's proposal, IHDA's letter of December 29th indicates that its proposal is "an acceptable allocation insofar as the owners are concerned."

On March 19, 1984, the Secretary rejected the increase in the Section 8 authorization for Grand Oaks originating from the reductions approved on August 31, 1983, and that recaptured Section 8 funds were required to be applied to elderly or handicapped housing projects under certain 1983 amendments to the federal housing laws. The Secretary also indicated that the August 31, 1983, reductions could be rescinded if certain conditions at the five complexes

including full utilization of the reduced level of assisted units and a promise that the "additional" units would be fully utilized) were satisfied.

In support of his actions, the Secretary presents generalized arguments as to the validity of regulations delegating authority to seek reductions in Section 8 units to state housing agencies. 24 C.F.R. §883.27. The secretary points out that under these regulations state housing agencies have discretion to seek such reductions, subject to HUD approval. The Secretary notes that state housing agencies develop and finance "new construction" Section 8 projects. consequently, they possess the expertise to properly allocate assisted units and the incentive to see that state funds expended to build these projects are well spent (through maximum

utilization of federal Section 8 funds). Although the Secretary attempts to portray IHDA as the repository of discretion in these matters, HUD does not (and could not) simply "rubber stamp" all IHDA proposals.

This Court need not decide whether these generalized justifications for the Secretary's reliance (at least in the first instance) upon recommendations by state housing agencies are or are not reasonable, for in this specific agency action they lend no support to the Secretary's decision on this administrative record. The Secretary cannot profess his reliance upon IHDA's expertise yet ignore the central purpose of IHDA's proposal. In its letter of December 29, 1983, IHDA labelled the result of the Secretary's decision to be "perverse" and "unacceptable to the

Authority." This is not to say that the Secretary must accept or reject IHDA proposals en toto. But here the Secretary eliminated ninety Section 8 assisted units from the DuPage, Cook and Lake Counties without any consideration of the effect of such an action, including the availability of low income housing in those areas.

(13) IHDA's evaluation, upon which the Secretary assertedly relied, considered at most the effect of a transfer of these units from five complexes with a subsidized/market rate unit mix of roughly 40%/60% to a complex that would become a 100% subsidized housing project. IHDA contemplated transfer rather than a reduction. Hence IHDA's effort, (none of which have been made a part of the record), along with any evaluation performed by HUD's Chicago

office during the month in which the reductions were pending prior to approval, assuming any were made (no such evaluations have been made a part of the record in this action), did not address the elimination of ninety assisted units from the market, which is the effect of the Secretary's action.[3] The Secretary's

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[3]Although the Secretary did indicate that the units eliminated could be restored, the showing of full utilization and additional demand required for restoration decidedly alters to status quo ante. Prior to the reductions, no such showing was required to maintain existing authorization levels and the complexes had not fully utilized all authorized Section 8 subsidized units. Further, IHDA chose to transfer the utilized units rather than push for an increase in utilization at the five apartment complexes. The Secretary's decision has deprived IHDA of its alternative option of vigorous contract enforcement, and indeed, of any choice in the matter. On June 14, 1985, the plaintiffs requested (and were subsequently given) leave to file as an additional exhibit HUD Transmittal No. 4350.3 Chg-1, issued 3/7/85 (the "Handbook") as an interpretation by the Secretary of the governing statutes and

regulations. See Burroughs v. Hills, 41 F.2d 1525, 1529 (7th Cir.1984) (HUD Handbook is without binding force on court but is entitled to notice as an official interpretation of statutes or regulations with which it is not in conflict). A portion of this Handbook addresses the conditions upon which an apartment complex owner may lease apartments allocated under ACC and HAP contracts for Section 8 recipients to persons ineligible for Section 8 assistance (i.e., the extent of permissable underutilization). The Court does not rely upon this document for its holding, although it arguably provides yet another articulation of agency enforcement policy which is inconsistent with the Secretary's challenged actions. However, the Court notes that the Secretary's attempts to explain away the Handbook provisions are notably unpersuasive (e.g. "provision stating that owners may rent `up to' 20% to their contract units to ineligibles does not mean that these owners cannot rent more than 20% to ineligibles (as that is merely the point at which the state housing agency may initiate sanctions); "the Handbook was never meant to suggest such a reading...(and) the Handbook will be revised to clarify this matter." Although Section 8 was fledgling program with an uncertain future when the developers signed the contracts at issue here by the time the Secretary made the challenged reductions. Section 8 had become a successful and established

failure to consider this "relevant fact" alone requires that his action be vacated and remanded.

In a report by the Comptroller General of the United States to Congress dated April 27, 1981 entitled "Lenient Rules Abet The Occupancy Of Low Income Housing By Ineligible Tenants," cites Chicago as an area with chronic problems of underutilization at "partially assisted" projects such as those involved here. In his report, the Comptroller stated:

> The occupancy of section 8 housing by ineligible households is a significant and costly problem. Although program rules allow some leeway for owners to rent units under Section 8 assistance contracts to

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program. accordingly, the logic of the Secretary's argument that he is bound to exercise his discretion as to contracts signed in the mid-1970's differently than those signed after 1981 is not self-evident.

> households ineligible to receive assistance, the rules are too lenient and some owners ignore them. Although ineligible tenants receive no direct subsidies, they do benefit from large, indirect financial subsidies and displace needy households.

In response to the investigation conducted by the Comptroller, the Secretary described the options available to him when owners fail to rent to eligible low-income tenants and underutilize the set aside units. In a letter to the General Accounting Office ("GAO"), dated October 22, 1980, Appendix VII to the April 27, 1981 Report the Secretary stated as follows:

> The new Section 8 Housing Assistance Payments (HAP) Contract has expanded the tools HUD may use to enforce owners compliance with the limitation on admission of market rate tenants. The owner's failure to comply with this limitation is considered a default under the Contract. The options available to HUD (and the contract

administrator) upon owner default include:

-reduction or suspension of housing assistance payments to the owner;

-denial of owner/agent participation in HUD programs until compliance is achieved, pursuant to the 2530 clearance process or temporary denial;

-reduction of the number of units under the Contract; and

-HUD assumption of control of project operations, including rent collection and payment of necessary expenses, through appointment of a receiver or obtainment of mortgagee-in-possession status.

While all these remedies are available, the most effective seems to be the reduction of suspension of assistance payments until the owner complies with the terms of the Contract. HUD assumption of control would be used only in the most extreme cases, where an owner has consistently and deliberately violated the terms of the Contract. The least attractive remedy is reduction of the number of units under the Contract since this may be what an owner is trying to achieve. However, this

may be a remedy of last resort. (emphasis added).

The problem of how to provide and allocate scarce low-cost housing to low-income persons is one that challenges legislatures, governmental agencies, urban planners and developers. It is essential that decisions in this area by government officials be clear and consistent with announced policy. This is especially important with respect to using decisions because of the limited scope of judicial review and relief available to persons aggrieved, such as the plaintiffs in this action. Without explanation, or other attempts to secure the Developers' compliance, the Secretary implemented the "least attractive" "remedy of last resort" which he realized would operate to reward project owners for their past efforts to evade the

obligations under the HAP contracts. Further, although Congress had chosen not to apply the 1981 full utilization policy retroactively, it had clearly demonstrated its preference for such a policy. In light of the admonitions of the GAO, the Secretary's own response and the spirit of the 1981 amendments to Section 8, it was incumbent on the Secretary to consider carefully action which rewarded past underutilization and explain fully his reasons for approving the reductions.

Since the Secretary's decision was clearly not based on considerations of all relevant factors, including the Secretary's own policy and regulations and the prior administrative record which set forth the history of increased allocations and underutilization at each complex, the decisions to reduce

subsidized units and to eliminate eligible units must be vacated, set aside and remanded for reconsideration.

IT IS THEREFORE ORDERED that:

(1) The non-federal defendants' motion for summary judgment is granted. Judgment will enter on Counts I and II against the plaintiffs and in favor of James Kiley, A.D. Van Meter and the defendant Developers.

(2) Count IV of the fourth amended complaint is dismissed without prejudice.

(3) The Secretary's motion for summary judgment is granted in part and denied in part. Judgment will enter in favor of the Secretary and against the plaintiffs on Count I of the fourth amended complaint and that portion of Count III directed to the Secretary's enforcement policies.

(4) The plaintiffs' motion for summary judgment is granted in part and denied in part. The Secretary's decision as expressed in letters of August 31, 1983 and March 19, 1984, is vacated and remanded to the Secretary for further consideration.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

AUDREY PRICE, et al., Plaintiffs,	)	
VS.	)	No. 83 c 6291
SAMUEL PIERCE, et al., Defendants.	)	

FINAL JUDGMENT

The plaintiffs filed their Complaint on September 8, 1983 and the plaintiffs' class was certified on April 14, 1984. Various interlocutory rulings were made during the actions.

On June 25, 1985, an order and a written opinion was issued herein upon the parties' cross Motions for Summary Judgment. Price, et al., v. Pierce, et al., 615 F. Supp. 173 (N.D. Ill. 1985). The June 25, 1985 order denied plaintiffs relief on all claims, except a portion of the Administrative procedure Act ("APA") claim against HUD. HUD's approval of

IHDA's request for reduction of Section 8 contract units at the defendant complexes was declared unlawful, vacated, set aside and remanded for further consideration.

In July, 1985 the plaintiffs filed Notice of Appeal. Thereafter, defendants Kiley and Van Meter filed a Motion to Dismiss the appeal, arguing the June 25, 1985 decision was not a final, appealable order. On October 2, 1985, the Seventh Circuit Court of Appeals dismissed the plaintiffs' appeal stating that the district court's June 25, 1985 decision "clearly contemplated further action on the part of the Secretary."

Thereafter, on November 1, 1985, HUD issued a subsequent decision in which it stated in part:

> On remand HUD has reconsidered IHDA's requested subsidy reduction and transfer, and has concluded that since the transfer cannot be approved, the reduction

> request is necessarily mooted and unapprovable. HUD will accordingly take the appropriate ministerial steps to reflect the District Court's vacation of the August, 1983 subsidy reductions of each of the involved projects to the level that existed before IHDA's requests of June and July 1983.

On November 22, 1985, the plaintiffs moved for entry of another judgment herein. The plaintiffs' motion was denied without prejudice on November 22, 1985.

On December 27, 1985, the plaintiffs filed a Notice of Appeal. On February 24, 1986, the Seventh Circuit Court of Appeals dismissed the plaintiffs' appeal, stating as follows: "Thus, we have no appellate jurisdiction over this case until the district court reopens its file and enters final judgment, which it retains jurisdiction to do."

On March 24, 1986, the plaintiffs moved the court to reopen the proceedings and enter a final judgment which motion is hereby granted.

Pursuant to this court's previous rulings, the plaintiffs were denied relief on all claims for damages and claims seeking declaratory and injunctive relief regarding the defendants' failure to utilize one-half of the available Section 8 units under contract between HUD, IHDA and the apartment complexes and no further action is pending with respect to any of the plaintiffs' claim herein. The parties represent that there has been no change in the facts or law which merit further consideration of the case.

The Court concludes and finds that all issues raised in this action have been addressed; that no further claims are pending before this Court; and

that the apartment complexes have been restored to Section 8 contract levels which existed before the unlawful transfer in August and September, 1983.

Therefore, in accordance with this Court's June 25, 1985 Memorandum Opinion and Order and the findings and conclusions stated herein, IT IS ORDERED that:

(1) Judgment is entered on Counts I and II of the fourth amended complaint against plaintiffs and in favor of James Kiley, A.D. Van Meter and the defendant developers.

(2) Count IV of the fourth amended complaint is dismissed without prejudice.

(3) Judgment is entered in favor of the Secretary and against the plaintiffs on Count I of the fourth amended complaint and that portion of

Count III directed to the Secretary`s enforcement policies.

(4) That portion of plaintiffs' claim in Count III challenging the Secretary's decision as expressed in letters of August 31, 1983 and March 19, 1984 is moot inasmuch as the relief sought has been granted by the Secretary.

ENTER:

William T. Hart
UNITED STATES DISTRICT JUDGE

Dated: April 4, 1986

42 U.S.C. §1437f. Lower-income housing assistance

Authorization for assistance payments

(a) For the purpose of aiding lower-income families in obtaining a decent place to live and of promoting economically mixed housing, assistance payments may be made with respect to existing, newly constructed, and substantially rehabilitated housing in accordance with the provisions of this section.

Authorization for contracts for assistance payments

(b)(1) The Secretary is authorized to enter into annual contributions contracts with public housing agencies pursuant to which such agencies may enter into contracts to make assistance payments to owners of existing dwelling units in accordance with this section. In areas where no public housing agency has been

organized or where the Secretary determines that a public housing agency is unable to implement the provisions of this section the Secretary is authorized to enter into such contracts and to perform the other functions assigned to a public housing agency by this section.

(2) To the extent of annual contributions authorizations under section 1437c(c) of this title, the Secretary is authorized to make assistance payments pursuant to contracts with owners or prospective owners who agree to construct or substantially rehabilitate housing in which some or all of the units shall be available for occupancy by lower-income families in accordance with the provisions of this section. The Secretary may also enter into annual contributions contracts with public housing agencies pursuant to which

such agencies may enter into contracts to make assistance payments to such owners or prospective owners.

5 U.S.C. §706. Scope of review

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall--

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be--

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law;

(E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or

(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

42 U.S.C. §1983. Civil action for deprivation of rights

Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory or the District of Columbia, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress. For the purposes of this section, any Act of Congress applicable exclusively to the District of Columbia shall be considered to be a statute of the District of Columbia.

24 C.F.R. §883.101 Purpose

Various States have established statewide housing finance or development agencies to encourage the provision of housing for low and moderate income persons and families. To enable these agencies to effectively develop programs to meet housing needs within their respective jurisdictions, set-asides under the Housing Assistance Payments Program may be provided under the provisions of this Subpart. Some of these agencies also finance the construction and rehabilitation of housing and assume the risks of default and foreclosure on developments they finance. To allow these agencies flexibility in developing programs to meet housing needs, special policies and procedures are provided.

need for housing assistance for the number and size of units applied for; and

(d) The proposed project co·plements the allocation program of the HUD field office.

24 C.F.R. §883.327 Reduction of number of contract units for failure to lease to eligible families

(a) If at any time, beginning six months after the effective date of the Contract, the Owner fails for a continuous period of six months to have at least 80% of the Contract Units leased or available for leasing by Eligible Families, the HFA, with the approval of HUD, may on 30 days notice reduce the number of Contract units to not less than the number of units under lease or available for leasing by Eligible Families, plus 10% of such number if the number is 10 or more, rounded to the next highest number.

(b) At the end of the initial term of the Contract and of each renewal term, the HFA, with the approval of HUD,

may, by notice to the Owner, reduce the number of Contract units to not less than (1) the number of units under lease or available for leasing by Eligible Families at that time, or (2) the average number of units so leased or available for leasing during the last year, whichever is the greater number, plus 10% of such number, if the number is 10 or more, rounded to the next highest number.

(c) HUD will agree to an amendment of the ACC to provide for subsequent restoration of any reduction made pursuant to paragraphs (a) or (b) of this section if HUD determines that the restoration is justified as a result of changes in demand and in the light of the Owner's record of compliance with his obligations under the Contract and if annual contributions contract authority is available; and HUD will take such

steps authorized by section 8(c)(6) of the Act as may be necessary to carry out this assurance (see §883.203).

24 C.F.R. §883.328 HUD review of contract compliance

HUD will review project operations at such intervals as it deems necessary to ensure that the Owner is in full compliance with the terms and conditions of the Contract. Equal Opportunity review may be conducted with the scheduled HUD review or at any time deemed appropriate by HUD.

UNITED STATES GENERAL ACCOUNTING OFFICE

Washington, D.C. 20548

The Honorable Lawrence B. Simons

Assistant Secretary for Housing-

Federal Housing Commissioner

Department of Housing and

Urban Development

August 21, 1980

Dear Mr. Simons:

In our current review of the cost-effectiveness of Section 8 partially assisted projects we have observed a problem that we believe warrants your attention. This is the practice of some Section 8 project owners who are leasing units, for which Section 8 assistance is available, to market rate tenants rather then Section 8 eligible households. The problem affects both partially and fully assisted projects. Although leasing to

such ineligible market rate households is permissible under the Section 8 regulations, we believe the current policy and procedures relating to their inclusion in assisted housing could be improved. As you know the Department of Housing and Urban Development recently (1) lowered to 10% the percentage of "assisted units" in any project which can be rented to households who are ineligible for Section 8, and (2) developed new sanctions for dealing with project owners who fail to comply with the 10% limitation. We agree with these changes, but feel that some additional measures are needed.

Since HUD is currently making revisions to certain of the regulations applicable to Section 8 and rewriting the Section 8 contract forms, we believe you should consider,

(1) further lowering the percentage limitation on ineligible households to 5%, with no exception for partially assisted projects,

(2) issuing explicit enforcement guidelines for use by HUD area offices in dealing with project owners who exceed the limitation on ineligible households and

(3) making the new percentage limitation on ineligibles applicable to completed projects for which the earlier 20% limitation is still in affect.

Our limited data collection indicates a significant number of

projects in which ineligible households meet or exceed the current applicable limits on occupancy by ineligibles. But regardless of how widespread or how limited the problem may be at present, we believe our findings warrant your attention because of the potential for greater occupancy by ineligible households in the future, and what may be a growing trend in some areas toward partially assisted projects, to which market rate tenants are much easier to attract.

We are therefore raising this issue now so that HUD can take action as early as possible and so that we can get your reaction before performing additional field work to establish the extent of the problem nationwide. A detailed explanation of our reasoning and further discussion of our views follows.

TWO OBJECTIONS TO THE POLICY OF LEASING TO INELIGIBLE HOUSEHOLDS

Objections to the exception allowing ineligible households to occupy Section 8 can be made on at least two grounds. First, occupancy of Section 8 contracted units by ineligible tenants probably frustrates the intent of the program by causing the program to fall short of its assistance goals, even though the money to achieve more has been made available by Congress. Second, the cost-effectiveness of the program is degraded since indirect subsidy costs which are incurred regardless of who occupies the housing units, must be counted against a lower number of assisted households.

THE IMPACT OF ALLOWING INELIGIBLE HOUSEHOLDS TO OCCUPY SECTION 8 UNITS

In order to assess the impact of the policy allowing ineligible households we looked at data on occupancy provided by three HUD area offices. In the Los Angeles area office the data was taken from the Management Information System and included a significant number of projects for which no data were recorded. We decided that information from that office was inconclusive. In the other two area offices, Chicago and Detroit, we estimate that at least 1000 units and 400 units, respectively, were occupied by households ineligible for Section 8.

In Chicago, 86% of all uninsured Section 8 units were housing eligible Section 8 households. Allowing for 3% vacancies among contracted units we can conclude that about 11% (or 950 units) of

the roughly 8900 new or substantially rehabilitated units for which Section 8 assistance is available are leased to ineligible households. This overall statistic is made up of projects exhibiting a wide range of variation in the percentage of assisted units occupied by eligible households. (See Table 4). One small project has had only 1 assisted household during several years of operation and presently houses no eligible tenants. Another project approved for occupancy by 164 assisted households has never exceeded 50 Section 8 eligible households. Several partially assisted projects have consistently rented roughly half of the number of units planned for assisted households to market rate households.

One partially assisted project which seemed to be limiting the number of assisted households to about half of those authorized had an extremely high overall vacancy rate of nearly 17%. These vacancies could have been eliminated if all units under HAP contract were leased to assisted households. Several of these partially assisted projects, which underuse the available Section 8 assistance are in the City of Chicago which has among the longest Section 8 and public housing waiting lists in the nation. (See Table 6). Other uninsured projects housed only eligible Section 8 households. The limited number of FHA insured projects in Chicago which are in operation are generally fully assisted and house only eligible tenants.

In the Detroit area office we obtained data on uninsured projects only, since it was more readily available and we were told that the FHA insured projects would generally follow the pattern noted in Chicago. Seven percent of all uninsured units covered by Section 8 assistance contracts monitored by the Detroit area office house unassisted households. At the end of June there were 6987 assisted units under lease of which 6563 were leased to eligible households, leaving 424 units leased to market rate households. (See Table 5 for examples of particular projects.)

In both area offices, a large number of units which could have served assisted households went to households who were never envisioned as Section 8 recipients. Meanwhile, the funds to

subsidize at least 1400 households went unused.

THE ISSUE OF ECONOMIC INTEGRATION

Our argument that the production goals of the program are frustrated by ineligible occupancy is not inconsistent with another stated program goal--economic integration. This is because economic integration is to be served by developing partially assisted projects and by favoring locations which provide a deconcentration of low income households. Once HAP contracts are signed, the number and location of assisted units have been fixed. Economic integration among the assisted units should be achieved by selection tenants across the "eligible" income spectrum. The regulations even allow for the inclusion of households whose incomes are initially low enough to qualify, but increase to the point where

they would no longer qualify. What we are arguing against is the use of units already ear marked for assisting low income households to house middle income households. For example, if a partially assisted project with 20% of its total units designated as assisted, fails to achieve this 20% assisted occupancy, the goal of economic integration is damaged since fewer households than planned, are housed in the integrated environment. On the other hand a fully assisted project which has, say, 15% of its units leased to market rate households still has a high concentration of low income families.

Project owners wishing to develop a more viable tenant population by attracting a wide income range among a projects residents, can do so within the eligible Section 8 population.

Eligibility currently ranges up to 80% of area median income for a family of four, while the average income of Section 8 households is much lower, with the bulk of eligible households nationwide being below the poverty threshold.

THE COST OF THE POLICY

The potential cost of allowing ineligible households to occupy Section 8 contracted units is quite large. This is because the indirect subsidy costs for the unutilized units, such as HUD administrative costs, the GNMA TANDEM discounts and tax expenditures (where tax exempt bonds are used), are incurred on behalf of ineligible households. These are in effect the hidden costs of providing assisted housing and when they are added to the direct subsidies for assisted units the total subsidy per assisted unit is substantially higher

than if all assisted units serve eligible households. This higher cost is illustrated by the calculations in Table 1, which show the possible consequences of leasing 10% and 20% of contracted units to ineligible households. The calculations are based upon an FHA financed project where GNMA purchases the mortgage and sells it at a discount. We estimate that allowing 10% of such units to be leased to ineligible households increases the subsidy to assisted households by $820 for 20 years of operation. If this additional expense were incurred to subsidize 500,000 units the additional cost occasioned by allowing ineligible households to occupy Section 8 units would be $410 million.

Another way of viewing the cost of the new 10% allowance for ineligible households is that for every 100,000

units financed under the new regulations with FHA TANDEM loans, 10,000 units (10%) will receive large per unit TANDEM subsidies, yet need never house subsidized tenants. Using the TANDEM subsidy cost figures shown in the footnotes to Table 1, we calculate a potential expenditure of $60,000,000 without any program benefits. This amount of money if applied directly to the purchase of multifamily housing could provide 2,000 dwelling units at $34,000 per unit. Although these illustrations are based on FHA financing, certain indirect costs would be incurred under any Section 8 financing mechanism, and in those involving tax exempt mortgage bonds, the potential costs of misutilizing units would be even greater.

Both these cost calculations assume that all units subject to the

exemption for ineligible households would actually house market rate tenants. This is very likely unrealistic, yet with a tight rental market throughout major portions of the U.S. and no relief in sight, the pressure for an increase in market rate tenant occupancy is probably quite strong. The cost estimates also show only one of the major subsidies which can be increased when units do not serve the intended beneficiaries and are based upon unit costs which are much lower than those we can expect to experience in the future.

THE PERCENTAGE OF ALLOWABLE INELIGIBLE HOUSEHOLDS COULD BE REDUCED

The exception for ineligible households could be further reduced from 10% to 5% for fully assisted Section 8 projects and eliminated altogether for projects where fewer than half of the

total units in the development are under Section 8 contracts. This would result in greater availability to needy tenants while reducing the total subsidy cost per household assisted.

Our understanding of the 10% exception is that it provides leeway to avoid unnecessary administrative problems in granting case-by-case exceptions any time a unit was leased to an ineligible tenant for unavoidable reasons. For example, a tenant might, after a period of time, go over income yet wish to remain, which the program allows.

We believe a 5% limit would allow this for even the smallest projects while insuring that if it happens repeatedly, the project owner would have to notify HUD and ask for permission.

For partially assisted projects where the owner already may have

significant leeway in choosing market rate versus assisted households each time a vacancy arises, we see no need for the exception. We noted in our limited data collection that for projects with less than half of the units under Section 8 assistance contracts, there seemed to be a greater likelihood that market rate tenants would occupy units for which assistance was available.

ENFORCEMENT GUIDELINES ARE NEEDED

With the adoption of the new regulations which were effective in November 1979, HUD now has a number of explicit sanctions for dealing with landlords who lease more than 10% of their assisted units to ineligible households. HUD may sue for specific performance of contract terms, suspend or debar the number of units under Section 8 contracts. It would therefore seem to be

an opportune time to issue clear guidelines to regional and area office personnel, spelling out acceptable limits within which they should expect project owners to comply, time periods for coming into compliance and a set of procedures which should be followed in enforcing compliance when necessary. To our knowledge no such guidelines exist even though the past HAP contracts probably provided sufficient authority for HUD to take a variety of actions against non-complying project owners, in addition to the reduction in contract units spelled out in the old regulations. Several field office personnel we spoke with felt this reduction in units was their only recourse and were reluctant to use this sanction at any rate. We agree with this view since reducing the contract units

has the effect of making permanent the loss of subsidized units.

To make sure that this reluctance to enforce the limitation on ineligible households does not persist in the future, we believe an explicit policy statement and specific guidelines on enforcement would be very effective. Better enforcement would be particularly important if our limited research, which showed that a minority of the projects accounted for most of the ineligible tenants, proves true in other areas of the country.

RETROACTIVITY TO PAST SECTION 8 CONTRACTS SHOULD BE EXPLORED

We believe that HUD should carefully explore the possibility of making the lower limitation on ineligible households retroactive to past Section 8 development. This should be done now

even if further investigation indicates that it does not appear to be a nationwide problem.

By the end of 1979, more than 5000 Section 8 projects, with in excess of 425,000 assisted units, had been started under the new construction and substantial rehabilitation portions of the program. Nearly all these units are covered by the earlier regulations allowing up to 20% of all contracted Section 8 units to be leased to ineligible tenants. Since all these units included non-recoverable indirect tax and financing related subsidies, the bulk of the program has the potential of being only 80% effective, but at much higher subsidy costs per unit than anticipated.

We do not have the statistics to make an accurate estimate of the current

nationwide situation since the Section 8 occupancy data is of uncertain and varying quality and extensive field work would be necessary. Nor can we predict the extent to which Section 8 owners will tend to admit ineligible (market rate) households in the future. What is certain is that the incentives to do so, and the market forces which make it possible will increase as the cost of housing grows and the scarcity of quality rental housing becomes more prevalent. If this problem develops to the point where many Section 8 owners come to rely on ineligible households as a significant part of their tenancy, then the political difficulty of making a retroactive change will increase proportionately.

Such a change is very likely possible and practical since it passes two sensible tests for a retroactive

policy adjustment. First, it would buttress the original intent of the program by maximizing the service of the program to the intended beneficiaries. Second, it would not cause any undue hardship on Section 8 project owners who, after all, contracted initially to house Section 8 eligible households. The change would merely reinforce the government's consistent position that assisted units should serve eligible households--that is, the change is reasonable given the purpose of the original assistance contract and the favorable financing terms afforded housing developers. Section 8 owners would still have the ability to serve a broad range of income eligible households under current eligibility rules if their motivation in admitting ineligible

households has been to provide economic integration.

SUMMARY

Program changes to reduce the impact of the exception for ineligible households in Section 8 housing projects could enhance the programs impact, increase its service to needy households, and reduce its per unit subsidy costs while having no apparent adverse affect on the owners and operators of Section 8 housing or the programs intended beneficiaries.

We hope that our thoughts on this matter will prove useful and constructive and would appreciate it if you would advise us of actions you intend to take in response to this problem. Should you have any questions on this matter or the contents of this report we would be glad to discuss them with you or your staff.

If so, you can call me or Mr. William Gaines, the team leader on this work, at 426-1645.

Sincerely yours,

Richard J. Woods
Associate Director

REPORT BY THE

COMPTROLLER GENERAL

OF THE UNITED STATES

LENIENT RULES ABET THE OCCUPANCY OF LOW INCOME HOUSING BY INELIGIBLE TENANTS

April 27, 1981

The occupancy of Section 8 housing by ineligible households is a significant and costly problem. Although program rules allow some leeway for owners to rent units under Section 8 assistance contracts to households ineligible to receive assistance, the rules are too lenient and some owners ignore them. Although ineligible tenants receive no direct subsidies, they do benefit from large, indirect financing subsidies and displace needy households.

The Department of Housing and Urban Development has agreed to take a number of corrective actions suggested earlier by GAO, but some aspects of the problem remain. GAO is therefore recommending further actions by both the Congress and the Department.

COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON D.C. 20548

The Honorable Jake Garn
Chairman, Committee on Banking,
Housing and Urban Affairs
United States Senate
The Honorable Fernand J. St. Germain
Chairman, Committee on Banking,
Finance and Urban Affairs
House of Representatives

While reviewing the cost effectiveness of Section 8 subsidized rental housing we observed that some Section 8 project owners lease units for which Section 8 assistance is available to tenants ineligible for rental assistance. Although limited leasing to ineligible or market-rate households is permissible when no eligible households are available and under certain other

conditions, we believe the current policy and procedures related to including ineligible tenants in assisted housing could be strengthened.

The Department of Housing and Urban Development (HUD) recently took a number of positive steps when it (1) lowered to 10 percent (from 20 percent) the percentage of Section 8 assisted units in any new project that can be rented to ineligible households without explicit HUD approval and (2) developed new sanctions for dealing with project owners who fail to comply with the limitation. We agreed with these changes, but believed additional measures were needed, since all previously completed projects continue to be covered by the older regulations and because HUD's enforcement options were still limited. Although HUD has promised to

make some further changes, the problem remains unsolved. Therefore, we recommend that the Secretary of Housing and urban Development:

> Modify program regulations for new, fully assisted projects to further lower the percentage limitation, from 10 percent to 5 percent, on the number of units that can be occupied by ineligible households without HUD approval and allow no ineligible households in contracted units in partially assisted projects without HUD approval.
>
> Issue explicit enforcement guidelines for use by HUD regional and area offices in dealing with project owners who exceed the limitation on ineligible households or otherwise fail to comply with HUD's policies on occupancy by ineligible households.
>
> Amend Section 8 regulations to explicitly state a project owner's responsibility to make every effort to rent all Section 8 contracted units to eligible households before utilizing the exception for ineligible households.

In addition, we recommend that the Congress consider whether a more stringent limitation on ineligible households should be applied to previously completed Section 8 projects. This limitation could be achieved by either:

enacting legislation to apply a 5 percent limitation to completed projects already under contract or

directing the Department to change its regulations to have the same effect.

Finally, we recommend that the Congress enact legislation to

clarify the program's original intent--that housing units for which Section 8 subsidy contracts are signed by used to the maximum extent possible for eligible households.

Our data on all projects in HUD's Los Angeles, California; Detroit, Michigan; and Chicago, Illinois, area offices indicates that in many housing projects, the number of ineligible households exceeds the applicable limits on

occupancy by ineligible households. This problem warrants prompt attention because (1) under present regulations the potential exists for greater occupancy by ineligible households in the future and (2) the incentives to house ineligible households and market forces that encourage it will increase as the cost of housing escalates and the scarcity of rental housing becomes more prevalent.

We brought this problem to HUD's attention in August[1] at a time when the agency was making changes to Section 8 regulations and contract forms. Although HUD promised to make several positive changes in occupancy and contract administration guidelines in response to our concerns, it argued against lowering further the administrative limitation on ineligible households and took the

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[1]Letter to the Assistant Secretary for Housing - Federal Housing Commissioner, dated August 21, 1980.

position that our suggestion to make such limitations retroactive to Section 8 projects already in operation was legally impossible. We concluded that the retroactive change was possible and would probably cause no real detriment to owners, but that litigation could result.

Our analysis of HUD comments on our August letter is in Appendix VI, and HUD's entire response is reproduced as Appendix VII. HUD declined to comment on the draft of this report because it felt that its response to our August letter was still applicable and that it had nothing to add at this time. HUD also declined to comment on the congressional recommendations, which were not included in the August letter.

OBJECTIVE, SCOPE AND METHODOLOGY

In a previous review by us of Section 8 housing, data gathered from

HUD's Chicago area office suggested that there might be a problem with ineligible households occupying Section 8 units. To determine the extent to which this problem existed in other areas, we selected the Chicago, Detroit, and Los Angeles area offices for data collection because of their large Section 8 portfolios. We did not include Los Angeles in our final analysis for reasons discussed later. (See p.5.) This review was performed primarily at HUD headquarters in Washington, D.C., with field data collection accomplished by telephone and mail.

Tenant occupancy data was collected from Section 8 Reports on Program Utilization (HUD form 52684), which provided figures on the total number of units in a project. These statistics were compiled by HUD area

offices at our request, and using these and other records, these offices also provided independent estimates of the number of ineligible (market-rate) households in Section 8 contracted units. We used these estimates as the basis for our findings. These calculations provided our starting point for assessing how HUD's limitation on leasing assisted units to ineligible households affected the effectiveness of Section 8 and for estimating the possible costs of various levels of the problem.

Cost estimates are based on a cost methodology developed in an earlier GAO report[2] and recent data on loan discounts absorbed by the Government National Mortgage Association (GNMA). We

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[2]"Evaluation of Alternatives for Financing Low and Moderate Income Rental Housing" (PAD-80-13, Sept. 30, 1980).

examined pertinent HUD regulations, contract forms, and handbooks and discussed ineligible occupancy with HUD program officials in Washington and each of the area offices. We also did an extensive legislative and legal analysis that helped us in framing our recommendations.

We did not attempt to measure the nationwide problem; however, the magnitude of the problem in Chicago and Detroit, discussions with HUD officials in other area offices, and a preliminary review of data on tenant occupancy in several other area offices suggest that this abuse of Section 8 contracted units exists elsewhere.

TWO OBJECTIONS TO THE POLICY OF LEASING TO INELIGIBLE HOUSEHOLDS

We have two objections to allowing ineligible households to occupy

Section 8 units. First, occupancy of Section 8 contracted units by ineligible tenants probably frustrates the intent of the program by causing it to fall short of its planned assistance, even though the money to achieve more assistance has been made available by the Congress. Second, the cost effectiveness of the program is degraded since indirect subsidy costs which are incurred--regardless of who occupies the housing units--must logically be counted against a lower number of assisted households.

THE IMPACT OF ALLOWING INELIGIBLE HOUSEHOLDS TO OCCUPY SECTION 8

To assess the impact of the policy allowing occupancy by ineligible households, we looked at occupancy data provided by three HUD area offices. Since two of these area offices showed significant numbers of ineligible

households, we suspended further costly data collection.

In the Los Angeles area office, data taken from the Management Information System included a significant number of projects for which no data was recorded. We decided that information from that office was inconclusive. In the other two area offices (Chicago and Detroit), we estimated that at least 1,000 units and 400 units, respectively, were occupied by households ineligible for Section 8.

In the Chicago area office, 86% of all Section 8 units not insured by the Federal Housing Administration (FHA) (most projects in operation are uninsured) were housing eligible Section 8 households. Allowing for the 3% vacancy factor that HUD gave us for Chicago area contracted units, we

estimate that about 11% (or 950 units) of the roughly 8,900 new or substantially rehabilitated units for which Section 8 assistance is available are leased to ineligible households. This overall statistic is made up of projects exhibiting a wide variation in the percentage of assisted units occupied by eligible households. One small project, which has had only one assisted household during several years of operation, presently houses no eligible tenants. Another project approved for occupancy by 164 assisted households has never exceeded 50 Section 8 eligible office projects showing the variation in the extent to which projects include ineligible households.

Several partially assisted projects in the Chicago area have consistently rented roughly half of the

number of units planned for assisted households to market-rate households. One project that seemed to be limiting the number of assisted households to about half of those authorized had an extremely high overall vacancy rate of nearly 17%. These vacancies, for which HUD very likely continues to pay subsidies, could have been eliminated if all units under a Housing Assistance Payments (HAPs) contract were leased to assisted households. Several partially assisted projects that are underusing the available Section 8 assistance are in Chicago, which has one of the longest Section 8 and public housing waiting lists in the nation. (See Appendix III.)

The limited number of FHA-insured Section 8 projects in Chicago that are in operation are generally fully assisted and house only eligible tenants.

In the Detroit are office, we obtained data on uninsured projects only, since it was more readily available and we were told that the FHA-insured projects would generally follow the pattern noted in Chicago. 6% of all uninsured units covered by Section 8 assistance contracts monitored by the Detroit area office house ineligible households. At the end of June, 6,987 assisted units were under lease, 6,563 of which were leased to eligible households, leaving 424 units leased to market-rate households. (See Appendix II for examples of particular projects.) Although the 6% may not appear detrimental to the Section 8 program, the loss of these contracted units to market-rate households is troublesome because we know that there is a great need for subsidized rental housing as evidenced by

the long Section 8 and public housing waiting lists.

In the Detroit and Chicago areas, a large number of units that could have served assisted households went to households that were never envisioned as Section 8 recipients. Meanwhile, the funds to subsidize an equal number of needy households went unused.

PROGRAM INTENT AND THE ISSUE OF ECONOMIC INTEGRATION

Our argument that the program's intent is frustrated by ineligible occupancy is not inconsistent with another stated program goal--economic integration. In fact, we believe ineligible occupancy also works against or fails to enhance economic integration in many instances. This is because the program was designed to assure economic integration by developing partially

assisted projects, by providing broad eligibility requirements, and by favoring locations that provide a deconcentration of low-income households, not by renting Section 8 units to higher income tenants. Once HAP contracts are signed, the number and location of assisted units should be fixed.

Economic integration among assisted units should be achieved by selecting tenants across the broad range of income-eligible households. The regulations allow for the inclusion of households whose incomes are initially low enough to qualify, but increase to the point where they would no longer qualify. This can further enhance economic integration. What we are arguing against is the use of units already earmarked for assisting lower income households to house middle-income

households, without regard to the availability of assisted households. For example, if a partially assisted project with 20% of its total units designated as assisted (and 80% for market-rate tenants) fails to achieve the 20% assisted occupancy, the goal of economic integration is actually damaged since fewer assisted households than planned are housed in the integrated environment. It seems unlikely that this is the kind of economically integrated environment envisioned in the legislation.

Project owners wishing to develop an economically diverse tenant population by attracting a range of incomes among residents in a project can do so within the eligible Section 8 population. Eligibility currently ranges up to 80% of area median income for a family. In actuality, the average income of Section

8 households is quite low, with the bulk of tenant households nationwide falling below the poverty threshold.

THE COST OF THE POLICY

The potential cost of allowing ineligible households to occupy Section 8 contracted units is quite large. This is because the indirect subsidy costs, such as HUD administrative costs, loan discounts absorbed by the Government (known as TANDEM), and tax expenditures (taxes foregone when tax exempt bonds are used) for units rented to ineligible households are incurred without providing any benefit to eligible households.[3] These are, in effect, the hidden costs of providing assisted housing to eligible program recipients, and when they are added to the direct subsidies for

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[3]See the footnotes for Appendix IV.

assisted units, the total subsidy per assisted unit is substantially higher than if all assisted units serve eligible households. This higher cost is illustrated by the calculations in Appendix IV, which show the possible consequences of leasing 10% and 29% of contracted units to ineligible households, which is now possible for projects already under contract. The calculations are based upon an FHA-financed project where GNMA purchases the mortgage and sells it at a discount. We estimate that the November 5 regulation change allowing 10% of such units to be leased to ineligible households could conceivably increase the subsidy to assisted households by $820 per unit for 20 years of operation. If this additional expense was incurred to subsidize 100,000 households, the

additional cost occasioned by allowing ineligible households to occupy Section 8 units would be $82 million.

Another way of viewing the potential cost of allowing a 10% exception for ineligible households to remain in force is that for every 100,000 units financed under the new regulation with FHA TANDEM loans, 10,000 units (10%) will receive large, per-unit TANDEM subsidies, yet may never benefit households in need of housing assistance. Using only the TANDEM subsidy cost figures shown in the footnotes to Appendix IV, we calculated a potential expenditure of $68,000,000, and none of these funds would provide housing to eligible households. This amount of money, if applied directly to the purchase of multifamily housing, could provide 2,000 dwelling units at $34,000

per unit. Although these illustrations are based on FHA TANDEM financing, certain indirect costs would be incurred under any Section 8 financing mechanism, and in those involving tax exempt mortgage bonds, the potential costs of misusing units are even greater since the indirect costs are much higher.

Both these cost calculations assume that all units subject to the exemption for ineligible households would actually house market-rate tenant occupancy is probably quite strong. The cost estimates are also understated since they reflect only one of the major per-unit indirect subsidies (TANDEM) and are based upon unit development costs, which are much lower than those we can expect in the future.

THE PERCENTAGE OF ALLOWABLE INELIGIBLE HOUSEHOLDS SHOULD BE REDUCED

We believe the exception for ineligible households should be further reduced from 10% to 5% for Section 8 projects where all units are under assistance contracts and eliminated altogether for projects where fewer than half of the total units are under Section 8 contracts. This change would result in greater availability of units to needy tenants while reducing the total subsidy cost per household assisted.

Our understanding of the 10% exception allowing some ineligible tenants is that it was set arbitrarily to avoid unnecessary administrative problems in granting case-by-case exceptions any time a unit is leased to an ineligible tenant for unavoidable reasons. For example, a tenant might, after a period

of time, go over income yet wish to remain in the project, which the program allows. We believe a 5% limit[4] would give sufficient leeway for even the smallest projects while ensuring that to exceed the limitation, the project owner would have to notify HUD and ask for permission. HUD takes the position that owners have the obligation to rent all contracted units to assisted households and the leeway to include market-rate households applies only when owners find it impossible to locate eligible tenants or when an eligible tenant goes over income. However, the actual wording of

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[4]Although we have no statistical basis for selecting 5%, we feel that if HUD does an adequate enforcement job, which it has promised to do, the 5% limit will essentially eliminate owner noncompliance and eliminate ineligible households except where ineligible occupancy is unavoidable for reasons already covered in HUD regulations.

the limitation in the regulation makes it appear that owners can exceed the limitation for up to 6 months before HUD will take action to enforce owner compliance.

For partially assisted projects where the owner already has significant leeway in choosing market-rate versus assisted households each time a vacancy arises, we see no need for the exception. We noted in our data collection that for projects that had less than half of the units under Section 8 assistance contracts and were therefore clearly partially assisted, there seemed to be a greater likelihood that market-rate tenants would occupy units for which assistance was available. HUD felt that this probably occurs because it is much easier to attract higher income tenants

to projects that have fewer low income tenants.

HUD felt that the current 10% limitation had not been in effect long enough to judge its impact and suggested delaying any further changes. We see no reason for delaying the change and discuss our reasons in Appendix VI

Recommendation to lower the exception for ineligible households

To reduce the number of Section 8 assisted units that can be leased to ineligible households, we recommend that:

> the Secretary of Housing and Urban Development further lower the percentage limitation on ineligible households from 10% to 5% for new, fully assisted projects without HUD approval.

ENFORCEMENT GUIDELINES ARE NEEDED

With the adoption of the new regulations, which were effective in November 1979, HUD now has several

explicit sanctions for dealing with landlords who lease more than 10% of their assisted units to ineligible households. HUD may reduce or suspend assistance payments, sue for specific performance of contract terms, suspend or debar the owner from HUD programs or, as in the past, reduce the number of units under Section 8 contracts. It would therefore seem to be an opportune time to issue clear guidelines to regional and area office personnel spelling out (1) acceptable limits within which they should expect project owners to comply, (2) time periods for coming into compliance, and (3) a set of procedures that should be followed to enforce compliance when necessary. To our knowledge, no such guidelines exist even though the past HAP contracts probably provided sufficient authority for HUD to

take a variety of actions against noncomplying project owners, in addition to the reduction in contract units spelled out in the old regulations. Several field office personnel we spoke with felt that this reduction in units was their only recourse and thus were reluctant to use this sanction and further hamper the achievement of the Section 8 planned assistance goals. We agree with this view since reducing the contract units has the effect of making permanent the loss of subsidized units.

To make sure that this reluctance to enforce the limitation on ineligible households does not continue, we believe specific guidelines on enforcement for use by area offices are needed. Better enforcement would be particularly important if our limited research, which showed that a minority of projects

accounted for much of the problem, proves true in other areas of the country.

HUD promised to take a number of steps aimed at better enforcement, which are discussed in detail in Appendix VI.

Recommendation it issue specific enforcement guidelines

To provide HUD regional and area office personnel with a set of guidelines for enforcing project owner compliance with limitations on ineligible household occupancy, we recommend that:

> the Secretary of Housing and Urban Development issue explicit enforcement guidelines for use by HUD regional and area offices to deal with project owners who exceed the limitation on ineligible households or otherwise fail to comply with HUD's policies on ineligible occupancy.

SHOULD A MORE STRINGENT LIMITATION BE APPLIED TO PAST SECTION 8 CONTRACTS?

We believe that the Congress should consider whether a more stringent limitation on ineligible households should be applied to past Section 8 developments already under assistance contracts.

HUD takes the position that it cannot retroactively and unilaterally raise what is in effect the enforcement level regarding ineligible households in existing Section 8 contract units. Although project owners could argue that doing so would illegally impair their contractual rights we believe that since present law requires that assisted (contract) units be occupied by eligible families, owners cannot use the terms of their contracts to avoid the effect of

statutory requirements. Making owners seek HUD approval when less than 95% (instead of 80%) of contracted units are occupied by eligible households could cause some added administrative burden, but owners could be compensated for any additional costs. Such costs might easily be outweighed by the benefits of providing more housing units to needy households.

The 1,400 units we found in two areas seem adequate motivation for a change, but more importantly, by the end of fiscal year 1979, roughly 6,000 Section 8 projects, with more than 450,000 assisted units, had been started under the new construction and substantial rehabilitation portions of the program. Most of these units are covered by the earlier regulations allowing up to 20% of all Section 8

contracted units to be leased to ineligible tenants without asking HUD for explicit approval. Since all these units benefited from nonrecoverable indirect tax and financing related subsidies, the bulk of all Section 8 projects have the potential of being only 80% effective, but with much higher per-unit subsidy costs than anticipated.

We do not have the statistics to accurately estimate the current nationwide situation, since the Section 8 occupancy data is of uncertain and varying quality and extensive field work would be necessary. We also cannot predict the extent to which Section 8 owners will tend to admit ineligible (market-rate) households in the future. What is certain is that the incentives to do so, and the market forces that make it possible, will increase as the cost of

housing grows and the scarcity of quality rental housing becomes more prevalent. If this problem develops to the point where many Section 8 owners come to rely on ineligible households as a significant part of their tenancy, the political difficulty of making a retroactive change will increase proportionately.

A retroactive change such as we suggest is very likely possible[5] and practical since it passes two sensible tests for a retroactive policy adjustment. First, it would buttress the original intent of the program by maximizing the service of the program to

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[5]There is precedent for the Congress to change the terms of contracts by legislation (Public Law 96-153, §503, later repealed). This is admittedly unusual and subject to challenge, but could be sustained in the case of a more stringent limitation on ineligible households, we believe, since the impact on project owners is minimal.

the intended beneficiaries. Second, it would not cause any undue hardship on Section 8 project owners who, after all, contracted initially to house Section 8 eligible households. The change would merely reinforce the Government's consistent position that assisted units should serve eligible households--that is, the change is reasonable given the purpose of the original assistance contract and the favorable financing terms afforded housing developers. Section 8 owners would still have the ability to serve a broad range of income-eligible households under current eligibility rules if their motivation in admitting ineligible households has been to provide economic integration. In the unlikely event that some financial damage is sustained by a project owner, the owner could seek compensation through the

courts. If owners find it impossible to find eligible households, HUD could still allow owners to rent to market-rate households, but the path of least resistance would be for them to seek eligible households in most situations. Ineligible households already occupying Section 8 units would be allowed to continue renting under existing provisions of the program regulations until they voluntarily terminated their tenancy.

Recommendation for a retroactive policy adjustment

To maximize service of the Section 8 program to its intended beneficiaries, we recommend that the Congress should consider whether a more stringent limitation on ineligible households should be applied to Section 8

projects already under contract. This could be achieved by either:

> enacting legislation to apply a 5% limitation to completed projects already under contract or
>
> directing HUD to change its regulations to have the same effect.

Recommendation that the Congress clarify program intent

Given the confusion regarding owner's responsibilities to rent only to eligible households seemingly conflicting HUD regulations, the complex issue of economic integration, and other factors that tend to complicate the problem of ineligible occupancy, we believe a clear signal on program intent from the Congress would make it much easier to set and enforce HUD policy regarding Section 8 occupancy. We therefore recommend that:

the Congress enact legislation clarifying the Section 8 program's original intent--that housing units, for which Section 8 subsidy contracts exist, be used to the maximum extent possible for Section 8 eligible households.

Copies of this report are being sent to the Secretary of Housing and Urban Development and the Assistant Secretary for Housing-Federal Housing Commissioner.

Acting Comptroller General of the United States

Department of Housing and
Urban Development
One North Dearborn
Chicago, IL 60602
April 19, 1982

Jeff Watkins, Resident Manager
Arrowhead Village
1912 Cambridge Ct.
Palatine, IL 60067

Dear Mr. Watkins:

We have received correspondence from Mr. A. F. Barnett of 1936 Cambridge Court. Mr. Barnett, who is a resident of Arrowhead Village, indicates that he has been denied an application for rental assistance under the federally-funded Section 8 Housing Assistance Payments Program. We are deeply concerned since our records indicate that of the 80 units

under you Section 8 Contract, less than 50% (39 units) are currently under lease to eligible Section 8 tenants.

Current regulations found in 24 CFR Part 883.605(a) require that no more than 10% of assisted units be leased to ineligible tenants without prior HUD and State Agency (IHDA) approval. Failure to lease to eligible tenants is a violation of your Contract and constitutes grounds for all available legal remedies, including specific preference of the Contract, suspension or debarment from HUD program and reduction of the number of units under the Contract.

Within 10 days following your receipt of this letter, we request your written response to the charge made by Mr. Barnett and a justification of your failure to lease Section 8 units to eligible tenants.

A copy of this letter is being forwarded to the Illinois Housing Development Authority.

Questions concerning this matter may be addressed to Ollice L. Kirksey, Occupancy Specialist. (312) 353-6610.

Sincerely,

Elmer C. Binford

Area Manager, 5.15

Department of Housing and
Urban Development
One North Dearborn
Chicago, IL 60602

June 9, 1982

Barbara A. Savot, Manager
Arrowhead Apartments
1912 Cambridge Ct.
Palatine, IL 60067

Dear Ms. Savot:

In our letter of April 19, 1982, we requested a written response to a complaint by Mr. A. F. Barnett of 1936 Cambridge and your explanation of your agency's failure to lease Section 8 units to eligible tenants. Inasmuch as we have not received additional contacts from Mr. Barnett, we can assume that his concerns have been resolved to his satisfaction.

Regarding the matter of your agency's failure to lease Section 8 units to eligible tenants, your response completely ignores this issue. In addition, you have provided us a copy of a response to the Barnetts from Donnell D. Jenkins, Amdur Associates, Inc., Property Manager that contains statements that contradict information contained on official HUD reports. Specifically, HUD Form 52684, Report on Program Utilization, which was filed on behalf of Arrowhead Apartments, by the Illinois Housing Development Authority indicates that as of January 13, 1981 only 39 of 80 units (50%) were leased to eligible tenants. Further information received by this office indicates that as of May, 1982, this situation has not improved. Any unauthorized policy of leasing to ineligible tenants above the allowable

program limit results in the unlawful deprivation of federally-funded rental assistance to eligible Section 8 applicants. This policy is especially disturbing since your agency acknowledges "a very lengthy waiting list for Section 8 at Arrowhead."

As was indicated in our letter of April 19, 1982, failure to lease to eligible tenants is a violation of your Housing Assistance Payments Contract and grounds for all available legal remedies.

In addition, your unauthorized policy has the effect of depriving those eligible families of their constitution right to participate in this federally-funded program.

We request a written response to this matter within 10 days following your receipt of this letter. If further assistance is needed, please contact Mr.

Ollice Kirksey, Occupancy Specialist at (312) 353-6610.

Sincerely,

Elmer C. Binford

Area Manager, 5.15

Department of Housing and

Urban Development

One North Dearborn

Chicago, IL 60602

June 25, 1982

Peter R. Dwars, Deputy Director

Illinois Housing Development Authority

Attention: Daniel R. Delong, Jr.

130 E. Randolph Street

Chicago, Illinois 60601

Dear Mr. Dwars:

Recently, it has come to our attention that IL06-H121-0907, Arrowhead Village, has consistently violated federal regulations by leasing Section 8 units to ineligible tenants in a percentage that exceeds statutory limits. We had requested that the owner of this project provide this office with some

clarification of this unauthorized procedure. As the result of our request, we were informed by an IHDA employee that your agency would provide an adequate response.

In a June 15, 1981, letter from Mr. Delong, we were provided with a response that we feel is less than adequate. We concur in Mr. Delong's analysis that this project is governed by regulations that were in effect prior to February 29, 1980; however, we are not aware of any federal regulations that allow a project owner to lease more than 20% of its Section 8 units to ineligible tenants. IL06-H121-007 has consistently leased more than 50% of its Section 8 units to ineligible families.

We would appreciate your response to this matter inasmuch as our records show that this project is being managed in violation of federal regulations.

Sincerely,

Elmer C. Binford

Area Manager 5.15

TRANSMITTAL HANDBOOK NO: 4350.3 CHG-1

1-1. **PURPOSE.** For owners, managers, HUD Field Office staff and Section 8 Contract Administrators, this is a one-source "rule book" on the occupancy policies and procedures governing the subsidized multifamily programs listed in Paragraph 1-2. This handbook does NOT supersede any Contract Administrator or owner rights and duties that are provided for in regulations or statutes.

(3) **Section 8 New Construction and Substantial Rehabilitation Units**

(a) If the HAP Agreement was signed on or after October 1, 1981, owners may **NOT** admit ineligible families.

(b) If the HAP Agreement was signed before October 1, 1981, owners may admit ineligible families up to the limit specified in the HAP Contract (i.e., 10% or 20% of the contract units). This does

NOT require prior approval from HUD or the contract administrator, but owners must first take all of the actions required by Paragraph 2-7c.

c. Actions Owners Must Take Before Admitting Ineligibles

(1) Admit all available eligible applicants, unless there is good cause for denying them assistance. (See Paragraph 2-21).

(2) Take all reasonable steps to attract eligible families, including using marketing activities most likely to attract eligible applicants.

(3) Place in the files of any ineligible tenants who are admitted a written certification that the steps required in (1) and (2) above have been completed.

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT SECTION 8 HOUSING ASSISTANCE PAYMENTS PROGRAM HOUSING FINANCE AND DEVELOPMENT AGENCIES

ANNUAL CONTRIBUTIONS CONTRACT

Part 1

Section 1.1. The Project. The HFA proposes to enter into a Housing Assistance Payments Contract ("Contract") with respect to newly constructed or substantially rehabilitated dwelling units pursuant to an Agreement to Enter into Housing Assistance Payments Contract ("Agreement") executed prior to the commencement of construction or rehabilitation. The numbers and sizes of units will be as follows:

Unit Type	1 Bedroom
Number of Units:	44
Size of Unit:	696 S.F.
Contract Rent:	$283
Gross Rent:	$303

Unit Type	2 Bedroom
Number of Units:	26
Size of Unit:	897 S.F.
Contract Rent:	$328
Gross Rent:	$353

The HFA shall enter into an Agreement and Contract in accordance with the numbers and sizes of units specified above. The HFA shall not enter into any Agreement or Contract or take any other action which will result in a claim for a total Annual Contribution in respect to the Project in excess of the maximum amount stated in Section 1.4(a).

Section 1.2. Authorization of Actions by HFA. In order to carry out the Project, the HFA is authorized to: (a) enter into and Agreement, (b) enter into a Contract, (c) make housing assistance payments on behalf of Families, and (d) take all other necessary actions, all in accordance with

the forms, conditions and requirements prescribed or approved by the Government; provided, however, that the HFA shall take no actions which would result in any obligation on the Government beyond that provided in the Government approved Agreement and Contract.

(b) Timely Performance of Work. The Owner agrees that no later than the date stated in Section 1.1(b) the work will be commenced and diligently continued. In the event the work is not commenced, diligently continued and/or completed as aforesaid, the HFA reserves the right, subject to Government approval, to rescind this Agreement or take other appropriate action. The Owner shall report to the HFA the date work was commenced and shall thereafter furnish the HFA with periodic progress reports

(quarterly or as otherwise required by the HFA).

Section 1.3 Construction or Rehabilitation Period.

(a) Changes. The Owner shall submit for HFA approval any changes from Exhibit A which would materially reduce or alter his obligations or any changes which would alter the design or materially reduce the quality or amenities of the project. Approval of such changes may be conditioned on a reduction of Contract Rents. If such changes are made without prior approval by the HFA, the Owner may be required to reduce the Contract Rents or remedy the defects or deficiencies as a condition for acceptance of the project. Contract Rents may not be increased by reason of any changes or modifications except those required by changes in local codes or

ordinances made subsequent to execution of the Agreement, and then only if Government approval is obtained prior to incorporation of any such changes in the project. If any changes under this paragraph are approved by the HFA, the HFA is required to submit to the Government, at such times as it deems appropriate, but not later than the certification of completion described in Section 1.4, a statement specifying the changes approved and either (1) a certification by the HFA that such changes do not justify a reduction of Contract Rents, or (2) a statement of the amounts by which Contract Rents were reduced and a certification that such reduction is appropriate and adequate in light of the changes approved.

(b) Commencement of Marketing. The Owner shall commence and diligently

continue marketing as soon as possible, but in any event no later than ninety (90) days (or sixty(60) days in the case of substantial rehabilitation) prior to the estimated completion date. The Owner shall notify the HFA of the date of commencement of marketing. The Owner shall also comply with all reporting requirements under the Affirmative Fair Housing Marketing Regulations. Not later than thirty (30) days prior to the estimated completion date and periodically thereafter, the Owner shall notify the HFA of any units which he anticipates will be vacant on the effective date of the Contract. At the time the Contract is executed, the Owner shall submit a list of the dwelling units leased as of the effective date of the Contract and a list of the units not so leased, if any. The Owner will be

entitled to housing assistance payments for any unleased units pursuant to Section 1.7(b) of the Contract only if he has fully complied with the requirements of this paragraph and the provisions of that Section.

(b) Right of Government if HFA Defaults under ACC or Contract.

(1) If the HFA defaults in the observance or performance of the provisions of Section 2.4; fails to comply with its obligations under any duly issued Certificate of Family Participation in accordance with its terms; fails to comply with the requirements of Sections 2.5, 2.6, 2.7, or 2.8; defaults in the performance or observance of any other term, covenant or condition of this ACC or of any term, covenant or condition of any Contract; fails, in the event of any default by the

Owner, to enforce its right under the Contract by way of action to achieve compliance to the satisfaction of the Government or to terminate the Contract in whole or in part, as directed by the Government; or fails to comply with the applicable provisions of the Act and the regulations issued pursuant thereto; the Government may, after notice to the HFA giving it a reasonable opportunity to take corrective action, determine that the occurrence of any such event constitutes a Substantial Default hereunder as to the Project. Upon the occurrence of a Substantial Default with respect to any Project, the HFA shall, if the Government so requires, assign to the Government all of its rights and interests under the Contract including any funds, and the Government shall continue to pay Annual Contributions with

respect to dwelling units covered by Housing Assistance Payments Contracts in accordance with the terms of this ACC and of such Contracts until reassigned to the HFA.

(2) All rights and obligations of the HFA assumed by the Government pursuant to this Section 2.16(b) will be returned as constituted at the time of such return(i) when the Government is satisfied that all defaults have been cured and that the Project will thereafter be administered in accordance with all applicable requirements, or (ii) when the Housing Assistance payments Contract is at an end, whichever occurs sooner.

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT SECTION 8 HOUSING ASSISTANCE PAYMENTS PROGRAM HOUSING FINANCE AND DEVELOPMENT AGENCIES

HOUSING ASSISTANCE PAYMENTS CONTRACT

Section 1.3. Families to be Housed, HFA Assistance.

(a) Families to be Housed. The Contract Units are to be leased by the Owner to eligible Lower-Income Families ("Families") for use and occupancy by such Families solely as private dwellings.

(b) HFA Assistance.

(1) The HFA hereby agrees to make housing assistance payments on behalf of Families for the Contract Units, to enable such Families to lease Decent, Safe, and Sanitary housing pursuant to Section 8 of the Act. Such housing assistance payments shall equal the

difference between the Contract Rents for units leased by Families and the portion of such rents payable by Families as determined by the Owner in accordance with schedules and criteria established by the Government.

(2) If there is an Allowance for Utilities and Other Services and if such Allowance exceeds the Gross Family Contribution, the Owner shall pay the Family the amount of such excess on behalf of the HFA upon receipt of funds from the HFA for that purpose.

Section 1.5. Annual Contributions Contract.

(a) Identification of Annual Contributions Contract. The HFA has entered into an Annual Contributions Contract with the Government, as identified in Section 1.1(f), under which the Government will provide financial

assistance to the HFA pursuant to Section 8 of the Act for the purpose of making housing assistance payments. A copy of the ACC shall be provided upon request.

(b) HFA Pledge of ACC Payments. The HFA hereby pledges to the payment of housing assistance payments pursuant to this Contract the annual contributions payable under the ACC for such housing assistance payments. The HFA shall not, without the consent of the Owner, amend or modify the ACC in any manner which would reduce the amount of such annual contributions, except as authorized in the ACC and this Contract.

(c) Government Approval of Housing Assistance Payments Contract. The approval of this Contract by the Government signifies that the Government has executed the ACC and that the ACC has been properly authorized; that the faith

of the United States is solemnly pledged to the payment of annual contributions pursuant to said ACC; and that funds have been obligated by the Government for such payments to assist the HFA in the performance of its obligations under the Contract.

Section 1.12. Reduction of Number of Contract Units for Failure to Lease to Eligible Families.

(a) After First Year of Contract. If at any time, beginning six(6) months after the effective date of this Contract, the Owner fails for a continuous period of six (6) months to have at least eighty percent (80%) of the Contract Units leased or available for leasing by Families, the HFA, with Government approval, may on thirty (30) days' notice reduce the number of Contract Units to not less than the

number of units under lease or available for leasing by Families plus ten percent (10%) of such number if the number is ten (10) or more, rounded to the next highest number.

(b) At End of Initial and Each Renewal Term. At the end of the initial term of the Contract and of each renewal term, the HFA, with Government approval, may, by notice to the Owner, reduce the number of Contract Units to not less than (1) the number of units under lease or available for leasing by Families at that time or (2) the average number of units so leased or available for leasing during the last year, whichever is the greater, plus 10 percent (10%) of such number if the number is ten (10) or more, rounded to the next highest number.

(c) Restoration of Units. The Government will agree to an amendment of

the ACC to provide for subsequent restoration of any reduction made pursuant to paragraph (a) or (b) of this Section if the Government determines that the restoration is justified as a result of changes in demand and in the light of the Owner's record of compliance with his obligations under the Contract and if annual contributions contract authority is available; and the Government will take such steps authorized by Section 8(c)(6) of the Act as may be necessary to carry out this assurance (see Section 1.6).

Section 2.7. Failure or Inability of HFA to Comply with Contract. The following provisions of the ACC are hereby made a part of this Contract:

"(a) Rights of Owner if HFA Defaults.

(1) In the event of failure of the HFA to comply with the Contract with the Owner, or if such Contract is held to be void, violable or ultra vires, or if the power or right of the HFA to enter into such Contract is drawn into question in any legal proceedings, or if the HFA asserts or claims that such Contract is not binding upon the HFA for any such reason, the Government may, after notice to the HFA giving it a reasonable opportunity to take corrective action, determine that the occurrence of any such event constitutes a Substantial Default hereunder. When the Government so determines, it shall have the right to assume the HFA's rights and obligations under such Contract, perform the obligations and enforce the rights of the HFA, and exercise such other powers as the Government may have to cure the

Default; however, whether or not the Government elects to proceed in this manner, the Government shall, if it determines that the Owner is not in default, continue for the duration of such Contract to pay Annual Contributions for the purpose of making housing assistance payments with respect to dwelling units under such Contract.

(2) All rights and obligations of the HFA assumed by the Government pursuant to this Section 2.16(a) will be returned as constituted at the time of such return (i) when the Government is satisfied that all defaults have been cured and the Project will thereafter be administered in accordance with all applicable requirements, or (ii) when the Housing Assistance Payments Contract is at an end, whichever occurs sooner.

(3) The provisions of this Section 2.16(a) are made with, and for the benefit of, the Owner, the HFA (but only in its capacity as Lender), or the Owner's other assignees, if any, who will have been specifically approved by the Government prior to such assignment. If such parties are not in default, they may, in order to enforce the performance of these provisions, (i) demand that the Government, after notice to the HFA giving it a reasonable opportunity to take corrective action, make a determination whether a Substantial Default exists under paragraph (a)(1) of this Section, (ii) if the Government determines that a Substantial Default exists, demand that the Government take action as authorized in paragraph (a)(1), and (iii) proceed against the Government by suit at law or in equity."

Section 2.9. Remedies Not Exclusive and Non-Waiver of Remedies. The availability of any remedy provided for in this ACC or in the Contract shall not preclude the exercise of any other remedy under this ACC or the Contract or under any provisions of law, nor shall any action taken in the exercise of any remedy be deemed a waiver of any other rights or remedies. Failure to exercise any right or remedy shall not constitute a waiver of the right to exercise that or any other right or remedy at any time.

Exhibit A

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

17 North Dearborn Street

Chicago, Illinois 60607

December 23, 1975

Mr. Irving Gerick, Director
Illinois Housing Development Authority
201 N. Wells Street
Chicago, Illinois

Dear Mr. Gerick:

Subject: Section 8 Proposal IL06-H121-007, Hawthorne Ridge Apts., Woodridge

You are hereby notified that this office has approved your/amended proposal, dated 12/12/75, to provide 176 Units of housing of which 70 Units are to be the subject of a contract for the making of housing

assistance payments on behalf of eligible lower-income families leasing such units. A reservation of annual contributions contract authority for this project in the amount of $291,089 is in effect. This is an increase of $170,585 from the amount previously reserved as stated in your Notification of Application Approval dated 7/18/75. Subject to the fulfillment of all administrative and statutory requirements, an Annual Contributors Contract will be prepared and executed covering the number and size of units described below:

Unit Size	No. of Units	Contract Rents
1 BR	44	$283
2 BR	26	328

This approval is based upon your proposal as submitted, including the

financing certifications required by 24 CFR Section 883.205(b). If, at any time, you make changes, including changes to your financing methods which would affect the correctness of any element of the financing certifications, you must submit such changes to this office for review and approval.

This approval supercedes the previous project approval of 35 assisted units, or 20% of the project, dated 9/30/75.